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Chairman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to testify today regarding the Federal Housing Administration (FHA) multifamily programs. The insurance provided by the FHA has facilitated the financing of safe, decent, affordable single family and multifamily housing, as well as critically needed healthcare facilities, for individuals and communities who may not otherwise have access to the capital needed to finance these transactions. And today, while we are seeing signs of economic recovery, FHA continues to support the acquisition and refinance markets, providing critical liquidity to the market while also managing risk to the government and taxpayers.

The Role of FHA's Multifamily Programs in the Bolstering Economic Recovery

When this Administration took office, the economy was on the brink. The nation was losing 753,000 jobs a month, our economy had shed jobs for 22 straight months and consumer confidence had fallen to a 40-year low. In the face of this turmoil, this Administration took dramatic steps to prevent a complete financial meltdown. Since the President has taken office the economy has added private sector jobs for 27 straight months, for a total of 4.3 million jobs during that period. Today, an economy that was shrinking is growing again and we continue our efforts to speed that growth as we fight back from the worst economic crisis since the Great Depression.

The single family housing market in particular has suffered through this crisis, requiring swift and aggressive response. With house prices falling and foreclosures spiking, the Federal Reserve and Treasury helped keep mortgage interest rates at record lows. To provide access to these low interest rates, the Administration supported Fannie Mae and Freddie Mac, and we took steps to help families keep their homes – through mortgage modifications and FHA's loss mitigation efforts. The results of these extraordinary but necessary actions are clear. Since April of 2009, more than 5.9 million individual homeowners have received mortgage modifications and more than 1.3 million FHA loss mitigation actions and early delinquency interventions. Nearly 15

million families have been able to refinance their homes and foreclosures are down by nearly 50 percent.

In the multifamily sector, the Administration took equally dramatic steps to stem the financial meltdown as it related to multifamily housing and to keep construction activity going. For example, responding to the collapse in investor demand for Low Income Housing Tax Credit program, the Administration implemented two Recovery Act programs to provide direct capital support for threatened low-income housing developments. HUD provided $2.25 billion in new grant funds through the Tax Credit Assistance Program (TCAP) and the Treasury Section 1602 program, also known as the "exchange program", allowed state Housing Finance Agencies to convert a portion of their 2009 tax credit allocations into cash. Together these two programs jumpstarted construction on 126,000 homes – adding needed supply as low-income renters (including many foreclosed homeowners) were struggling to access affordable homes.

The Treasury Department's New Issue Bond Program (NIBP) is yet another example of decisive action by the Administration. NIBP allowed State and local Housing Finance agencies to issue new housing bonds at a moment in time when the marketplace wasn't otherwise interested in municipal tax-exempt issuances. Under NIBP, Treasury purchased approximately $15 billion in GSE securities backed by Housing Finance Agency (HFA) housing bonds. This liquidity allowed the HFAs to issue new housing bonds, consistent with what they would ordinarily have been able to issue with the allocations provided them by Congress, had there been traditional bond purchasers available. While much of the NIBP capital went to support HFA single family mortgage programs, the NIBP also supported HFAs in financing tens of thousands of new rental housing units for working families. The National Association of Local Housing Finance Agencies' estimates suggest that of the 24,000 rental units supported by NIBP, one in four would not have proceeded but for NIBP. And of those affordable multifamily developments that did go forward, their estimates suggest 10-15% less in additional subsidy was required by local, state and federal sources.

And, while the role of FHA in stabilizing the housing market is often spoken of in terms of the single family market, perhaps less heralded, but no less important, has been the role that FHA has played in providing critical liquidity for multifamily developments in the market during times of economic constriction. Under the FHA's General and Special Risk Insurance Fund (GI/SRI), FHA insurance has long assisted the nation in meeting the needs for safe, decent and affordable housing by facilitating financing to develop, rehabilitate and refinance multifamily rental housing. The financial recession, combined with historically low interest rates, and improvements in HUD business operations, led to an unprecedented increase in demand for FHA mortgage insurance over the last three years. This was particularly pronounced in certain types of multifamily housing and in regions of the country where conventional lending was inaccessible absent federal credit enhancement. FHA's ability to quickly scale up allowed it to play a countercyclical role that helped keep private investment flowing when conventional financing resources had otherwise retreated from the market.

Demand for new FHA insurance for new construction and refinancing of multifamily properties increased more than five-fold from 2008 to 2011, rising from $2.3 billion in FY 2008 to $12.4

billion in FY 2011. By the end of FY 2011, FHA's portfolio of multifamily loan guarantees had an unpaid principal balance of $50 billion on 9,977 loans. And today, while volume increases have stabilized, HUD expects elevated levels of mortgage insurance activity for the remainder of Fiscal Year 2012 and through Fiscal Year 2013. A significant share of the demand for FHA insurance reflects the larger demand for rental housing, particularly in many metropolitan areas which face an inadequate supply of multifamily housing. The ongoing demand for new rental housing is directly attributable to two factors, both attributable to the market downturn: (1) as many as 3.9 million former homeowners have been displaced by mortgage distress and are now in the rental market and (2) as many as 4.3 million new renter households, including many who postponed new household formation between 2008-2012 (for example, the number of 25 to 34 year olds living with parents was almost 50% higher in 2011 than in 2003).

In addition to providing critical liquidity to the marketplace, FHA insured multifamily developments also have a significant impact on communities by expanding affordable housing options, spurring economic development, and creating jobs. FHA estimates that the multifamily new construction loans endorsed by FHA in FY 2011 alone directly created 22,146 jobs, and supported the creation of 32,380 additional indirect or jobs. In total, FHA-insured multifamily projects yielded approximately 54,526 jobs throughout the nation. Clearly, FHA's multifamily new construction insurance program offers much more than just financing -- it creates jobs and improves the quality of life in communities nationwide.

While FHA's counter-cyclical role was crucial to mitigating the worst of the financial recession, its expanded footprint in multifamily finance is presumed to be temporary. FHA sees its role today as encouraging the return of private capital back into the mortgage market while balancing the need to remain a supportive mechanism for all types of housing moving forward, particularly for underserved markets and for lower income families. The good news is that private capital is returning.

Multifamily starts are up and much of that activity is being fueled by financing not insured by FHA. HUD's U.S. Housing Market Conditions Report indicates that during the first quarter of 2012, builders started construction at a seasonally adjusted annual rate of 196,000 new multifamily units, up 5 percent from the fourth quarter of 2011 and 27 percent from a year earlier... And even more encouraging, builders took out new building permits for multifamily developments at a seasonally adjusted annual rate of 232,000 new multifamily units, up 12 percent from the fourth quarter of 2011 and 61 percent from 1 year earlier. Of this new product that is being developed, the data suggests that much of it is being financed by conventional (non-FHA insured) debt sources. According to estimates provided in the Mortgage Banker Association Annual Report, while the number of FHA-insured initial endorsements is up overall by 17% (from $10.6 billion to $12.4 billion) from 2010 to 2011, its share of the marketplace is actually down by 26% (from 21.7% to 16.13%) over the same period.

The central role of housing in the U.S. economy demands that Federal agencies involved in housing policymaking manage programs and policies to support housing as a stable component of the economy, and not a vehicle for over-exuberant and risky investments. Today, an economy

that was shrinking is growing again; instead of rapid job loss, 4.3 million new private sector jobs have been created in the last 27 months.

Managing Risk in FHA's Multifamily Programs

Since the start of this Administration, FHA has taken a number of comprehensive steps to improve its risk management capabilities and processes to ensure the ongoing solvency of the FHA insurance funds. The creation of the Office of Risk Management and Regulatory Affairs (ORM), authorized by a Congress, has allowed FHA to enter into the 21st century, implementing guidance, rules and risk analytics allowing FHA to better assess its risk. The Deputy Assistant Secretary for Risk Management and Regulatory Affairs oversees the coordination of FHA's efforts to focus risk management in a single division devoted solely to managing and mitigating risk to the FHA insurance funds - across all FHA programs.

In Multifamily, we have engaged in a series of program specific steps to ensure that we are taking the appropriate steps to manage and mitigate risk. These changes reflect the first update to some of the standards governing FHA insured multifamily programs in 40 years. Leveraging the lending industry's best practices and standards, these changes are a much needed step to insure that FHA multifamily programs are sound and will continue to be available to fulfill our mission of providing liquidity to the multifamily market and decent, affordable rental housing to our nation's communities. These changes also ensure that FHA's multifamily programs are designed to meet the needs of communities across the nation.

Updated Underwriting Standards and Heightened Qualifications

HUD recently proposed a change to multifamily lender approval that would require all new and existing multifamily lenders and underwriters to undergo an additional screening process to ensure that they are qualified and experienced before receiving approval to participate in some specialty multifamily insurance programs. Under the new policy, a separate lender approval will be required to offer the more complex FHA insurance programs, such as those for new construction, substantial rehabilitation and Low-Income Housing Tax Credits.

This shift is a result of analyzing outcomes associated with the Multifamily Accelerated Processing (MAP) program, which show that certain FHA programs demand skilled lenders and underwriters with specialized knowledge. Currently, HUD offers the full range of FHA programs out of its field offices without regard to specialized expertise.

As part of risk mitigation, FHA has already implemented revised underwriting standards to raise debt service coverage ratios, lower loan to value and loan to cost ratios, increase project reserves and sponsor equity investment, and limit sponsor cash out. Underwriting ratios are now targeted to different property types based on their risk profiles, with lower ratios for subsidized affordable housing properties and higher ratios for market rate properties.

Finally, to assure critical analysis of the risks of proposed transactions by MAP underwriters, FHA is drafting a Mortgagee Letter that will require a standard underwriter's narrative be used for applications submitted under all insurance programs. Currently, each lender uses its own narrative which leads to uneven and sometimes inadequate analysis of transaction risks. The new policy will also require that a standard table of contents be used to organize application submissions – a simple step toward ensuring consistent and complete presentation of the underwriting materials and to facilitate efficient review of the application package by HUD staff.

Breaking Ground: Delivering Results

Amid rapid growth for FHA multifamily housing programs, FHA was hard pressed to keep pace with the demand. Since 2008, firm commitments issued in FHA's multifamily programs have increased over five times. Not surprisingly, processing times have increased as well. During this period of increased activity, FHA took steps to reduce the processing time of loan applications.

Through the *Breaking Ground: Delivering Results* initiative, the Office of Multifamily Housing reduced the processing time of loan applications and improved employee morale while protecting the taxpayer. Through *Breaking Ground,* the Office of Multifamily Housing has centralized processing of Section 223(a) (7) loans to the Office of Affordable Housing Preservation which allows Multifamily Field Office staff to focus on the increasingly complex transactions in their pipeline. Additionally, Multifamily Housing has initiated a queue, an early warning screening system, and other management tools in order to more efficiently manage workload and provide greater transparency to lenders and borrowers regarding the status of their loan applications. In addition, FHA continues to conduct monthly performance dialogues with field staff to discuss progress toward meeting processing goals and identify proactive solutions to address performance deficiencies in order to ensure that every effort is taken to reduce processing times and get funds into communities. Finally, FHA has moved applications to various processing centers, using the existing Hub structure, in an effort to clear the backlog and balance workloads across offices.

This initiative continues to produce encouraging results. The total backlog in offices that have completed *Breaking Ground* has decreased by almost 75%. Specifically, the number of applications that have been in processing for over ninety days has dropped from 191 to 50 in just seven months. Furthermore, HUD staff is excited about *Breaking Ground:* Survey results demonstrate that over 83% of HUD multifamily staff believes that the program will help their office to become more effective and efficient. Staff morale has also improved significantly in the offices that have completed the program. Almost 90% of staff now feel encouraged to come up with new and better ways of doing things.

The Department also will shortly embark on a similar initiative "*Sustaining Our Investments*" to deal with the asset management functions for the changing FHA portfolio. The purpose of this initiative is to make existing asset management processes more efficient and effective, identify opportunities to enhance risk management processes within the market rate portfolio and improve our service delivery to our stakeholders. FHA also conducts monthly performance dialogues with field staff to discuss progress toward meeting program goals and to address performance deficiencies in order to ensure that the Department is mitigating risk to the GI/SRI.

Loan Committee

FHA Multifamily has also implemented a new loan committee approval process, aligning Hub and Program Center commitment authority and practice to ensure consistency in underwriting throughout the regional offices, as well as to provide a platform to share best practices. Loan committees at the Hub and National levels provide oversight for high risk transactions in the multifamily insurance program, based on loan size and a project's number of units. Loan committee approval processes are standard practice in the lending community and are an important tool to prudently manage credit risks and ensure the integrity and stability of the GI/SRI insurance fund. The Loan Committee has also proven to be an effective tool for increasing communication and a more consistent FHA platform

Adjusting Premiums

Given the unprecedented increase in the number and dollar volume of loans insured under the GI/SRI, particularly with respect to "market rate[1]" loans, in the President's Fiscal Year 2013 (FY 2013) Budget, the Department proposed premium increases for programs in the GI/SRI. This is the first premium increase in 10 years for these programs. The GI/SRI funds provide financing for the FHA multifamily and healthcare loan guarantee programs and several very small specialized loan products. These accounts also continue to hold a sizable portfolio of single family loan guarantees (HECM, condominium, and rehabilitation loans) insured prior to FY 2009 when responsibility for new lending under these programs was transferred to the Mutual Mortgage Insurance Fund.

In contrast, premiums for single family programs situated in FHA Mutual Mortgage Insurance (MMI Fund) have been increased four times since 2010. As with the premium increases for MMI programs, the proposal to increase premiums for market rate loans originated under the GI/SRI is intended to ensure that FHA products are priced appropriately to compensate for FHA's risk, consistent with current market conditions. This premium change should also have the indirect benefit of encouraging the return of private capital to the nation's mortgage markets.

FHA's risk profile has significantly changed since the market crisis beginning in 2008. The proposed increase in GI/SRI premiums will ensure that we are compensated for this new risk element associated with a bigger significant market rate based portfolio.

In April 2012, FHA published a notice in the Federal Register soliciting comment on the GI/SRI premium increase proposal. The proposed increases range from 5 basis points for 223(a)(7) refinancing to 20 basis points for 221(d)(4) new construction or rehabilitation activity. The increase premiums will have no impact on either development costs or rents. And, as the

[1] Generally, market rate housing covers a range of rental housing opportunities. In the FHA portfolio, market rate housing is generally affordable to those at approximately 80% of area median income.

Department monitors the programs, the impact of implementing the proposal, and the interest rate environment, the Department will consider adjusting the premiums as appropriate. It is also important to note that premiums for affordable housing projects (such as those with HUD rental subsidies and low income housing tax credits, as well as those insured under FHA risk-sharing programs) will not be increased under the proposal.

Given that the elevated role FHA is currently playing in the market is temporary, the proposed FHA premium structure brings FHA's pricing more in-line with the private mortgage insurance industry and enables more robust private competition while continuing to ensure sufficient levels of available capital in these sectors. The increase in premiums also reflect new realities – the Multifamily annual book of business is five times greater than it was just three years ago, and the risk profile has changed dramatically. FHA's multifamily apartment portfolio is now more than 50 percent market rate by unit count and 70 percent by unpaid principal balance (UPB), which adds a new component of risk, and a need to take steps to ensure the future viability of the portfolio. These risks are not yet fully captured by historical claim and default trends because they are too new to have matured as risks to the portfolio. Further, because of historically low rates, it is likely that FHA will "own" these risks for a very long time as it is unlikely that borrowers will refinance any time soon.).

Going forward, FHA will continue to examine its business models and practices, with an eye toward continuing to improve its risk management capabilities while expediting processing and approval timelines. These efforts will further enable FHA to facilitate the availability of affordable housing in a responsible manner.

The Role of FHA Multifamily in Preserving Affordable Housing

As part of our overall mission, HUD remains truly committed to preserving affordable housing. Over the past few years, with the loss of affordable housing units as a growing problem, we have put forth a conscious strategy to ensure continued access to affordable housing units in communities across the country.

Over the last 10 years, for every three units of affordable housing that are created, we are losing two. Hundreds of FHA direct and insured multifamily mortgages are set to mature this year and next. Over the next 10 years, mortgages will mature on approximately 2,000 Section 202, Section 236 and Section 221(d)3 BMIR properties that are home to nearly 200,000 low, very low and moderate income households. When the mortgages mature, the underlying use and affordability restrictions expire, putting the long term affordability of these projects at risk. The Department is taking this challenge head on, with a number of new Notices and policy efforts directed at preservation. And, to accomplish this goal, HUD has taken a number of steps administratively to protect and preserve affordable properties.

In an effort to keep low-income families and elderly tenants in their homes, we're creating more options for owners who participate in our programs. The *Supportive Housing for the Elderly Act*

of 2010, provides new flexibilities and opportunities for Section 202 owners that refinance. One of the new flexibilities that HUD is currently implementing includes the option of using proceeds from a refinance in other HUD assisted senior housing properties.

We also just published a notice that removes the Mark-to-Market three-year limitation for debt relief. By removing the three-year limit, there are no time limits on the authority; so we are increasing access to qualified non-profit preservation owners interested in acquiring restructured properties. The notice also specifies preservation criteria that will facilitate assignment of restructured debt to qualified non-profits and clarifies that all restructured properties are now eligible - subject to the criteria in the notice- putting non-profit debt relief transactions within reach for the entire Mark-to-Market portfolio.

Additionally, in recognition of the fact that it can be difficult to leverage tax credit financing with FHA insured deal, earlier this year HUD announced a Low Income Housing Tax Credit Pilot. The pilot, which has rolled out with test sites in four hubs – Chicago, Detroit, Los Angeles and Boston – will allow FHA to increase the availability of affordable units by streamlining HUD's internal applications processes.

Another key preservation effort is the *Rental Assistance Demonstration* (RAD), which allows projects funded under the Public Housing, Section 8 Moderate Rehabilitation, Rent Supplement, and Rental Assistance Payment programs to convert their assistance to long-term, project-based Section 8 rental assistance contracts. Under the initial RAD Notice published in March, there are already seven projects with several hundred units in the process of conversion, with tens of thousands of additional units anticipated following publication of the final notice this summer.

In addition to these program reforms, we are working hard to "build the preservation toolbox" and provide Multifamily owners, management agents and residents with information and tools to work together to preserve assisted housing. As part of this effort, we have launched the "Partners in Housing", a multifamily preservation training series in seven cities around the country. This series has provided hundreds of owners, who represent tens of thousands of assisted units, with comprehensive training to recapitalize and improve their properties and commit to long term affordability. In addition, the Tenant Resource Network grant program NOFA competition is underway and we will make awards to nonprofit organizations to engage and educate residents of Section 8 properties on preservation options and opportunities, to ensure the voices of low-income residents are heard.

Preserving Affordable Units in Small Multifamily Buildings

As part of the Fiscal Year 2013 Budget, HUD is seeking legislation to facilitate lending to small multifamily properties which are an important provider of affordable, but unsubsidized, housing for low and moderate-income families. According to the 2010 American Community Survey, nearly one-third of renters live in 5 to 50 unit buildings. These buildings also tend to have lower median rents than do larger properties: $400 per month for 5-49 unit properties as compared to

$549 per month for properties with 50 of more units. Because they are expensive to finance, particularly in this environment, these properties are at risk of divestment.

HUD is proposing two legislative changes-one change to the Section 542(b) Risk Share program that would allow the Department to explore flexibility with the 542(b) Risk Share program to work with experienced affordable housing lenders to make Risk Share loans to small properties and the second change would allow Ginnie Mae to securitize risk share loans under Section 542(b). These changes would allow HUD to enter into Risk Share agreements with qualified lenders –such as well-capitalized Housing Finance Agencies or Community Development Financial Institutions – that have demonstrated experience making loans to support affordable housing and neighborhood stabilization. Under these Risk Share agreements, qualified lenders could make refinance, acquisition or rehab loans available to small (5 to 49 unit) properties. Lenders approved by Ginnie Mae could then securitize those loans on the secondary market, increasing the availability of capital for more multifamily lending.

HUD's proposal to improve the resources available to small building owners is part of the Department's broader commitment to re-balance the nation's housing policy to support rental housing and neighborhood revitalization. As Federal and state budgets shrink and the need for quality, affordable rental housing is on the rise, it's critical that we support small businesses who are finding solutions that work for families and for local economies – especially when those solutions come at no cost to the taxpayer. We look forward to working with Congress to ensure the availability of these unsubsidized, affordable housing units.

Conclusion

Madam Chairman and Ranking Member Gutierrez, as important as the FHA is at this moment, I want to emphasize that the elevated role it is playing is temporary – a bridge to economic recovery helping to ensure that mortgage financing remains available until private capital returns.

When demand for FHA's Multifamily mortgage insurance programs increased dramatically both in refinancing and new construction, the Department played an integral role in helping to avert a major financial crisis by providing needed liquidity to the multifamily financing market. In addition to the stabilizing influence that this liquidity provided to the financing market, the use of FHA programs facilitated the development of both market rate and affordable rental opportunities throughout the country in many markets where demand for rental housing is high and supply is tight. The changes and legislative requests that we have announced are crafted to ensure that FHA appropriately manages its business as it plays an elevated role in the market at present, and is able to step back to facilitate the continued return of the private sector as soon as possible. Until private entities can and will supply necessary levels of mortgage capital on their own, they need the FHA – and so does our housing market.

So, Chairman Biggert, while FHA must remain a key source of safe mortgage financing at a critical moment in our country's history, we recognize the risks that we face and the challenges of this temporary role that we play in today's market. And the bottom line is this: for the sake of

both borrowers and American taxpayers, the loans that FHA insures must be safe and self-sustaining over the long-term. Thank you for the opportunity to testify. I would be pleased to answer any questions the members of the subcommittee may have.