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on behalf of the Mortgage Bankers Association

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

"The Role of FHA in the Multifamily Mortgage Markets"

June 7, 2012

Chairwoman Biggert, Ranking Member Gutierrez and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA) on the roles of the Federal Housing Administration (FHA) insurance programs for the financing of multifamily and healthcare properties. While much attention has been paid to the single family homeownership programs and markets, we appreciate the subcommittee's focus on the financing of multifamily and healthcare properties that house a significant, and growing, percentage of Americans.

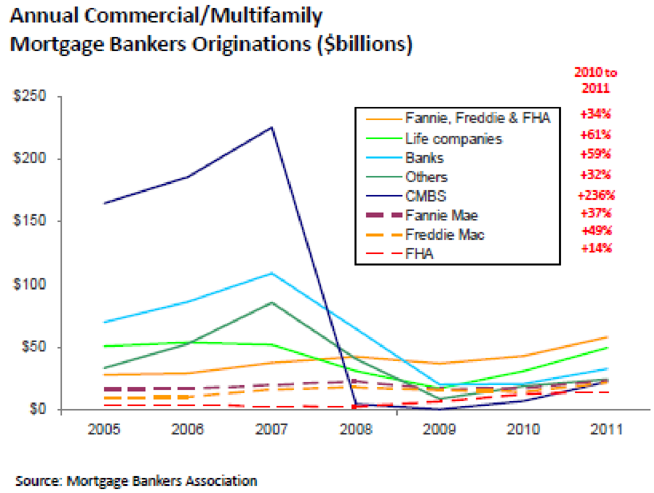
My name is Rodrigo Lopez and I am President and CEO of AmeriSphere Multifamily Finance. Headquartered in Omaha, Nebraska, AmeriSphere is one of the top 25 FHA multifamily and healthcare lenders, with over $200 million in FHA production in FY2011 – and we are on pace to produce another $ 200 million in FY2012. AmeriSphere has more than 50 employees in five offices across the country. My responsibilities include overseeing strategic planning and assessment for all of the company's loan programs, including multifamily programs with Fannie Mae and FHA. I am testifying on behalf of MBA, which represents the real estate finance industry, including a broad range of multifamily finance institutions.

FHA's Role in the Market

The recent housing crisis put a spotlight on the importance of multifamily rental housing and FHA's critical role. One in every three households lives in rental housing, and over the course of a lifetime, most Americans will rent at one time or another. Rental housing supports students going to school away from home, workers relocating to find employment or seniors choosing to rent, as well as others who rent because they cannot afford to purchase a home or because they prefer the locations, amenities and lifestyles that may accompany renting.

FHA significantly increased its role in the multifamily market during the recent recession as other market participants pulled back. As demonstrated in the charts below, volumes of commercial and multifamily loan originations reached their peaks in 2007 and dramatically decreased in 2008 and 2009 (Chart 1). Many capital providers began reentering the market in 2009 and have steadily increased in 2010 and 2011. On the other hand, Fannie Mae, Freddie Mac and FHA stayed in the markets in 2008, 2009, 2010 and 2011.

Chart 1



Looking specifically at FHA volumes, Chart 2 indicates the countercyclical nature of the FHA business, with volume lows during the years when the CMBS market was lending in large volumes and banks and life companies were also heavy providers of multifamily debt. But FHA volume began to increase as the private market pulled back and actually peaked in FY2010 for the two major programs for purchase/acquisition (223(f)) and new construction/substantial rehabilitation of apartments (221(d)). (The 223(a)(7) program is somewhat of an anomaly because it involves solely the refinancing of loans with FHA-insured mortgages, similar to a loan modification.)

Chart 2

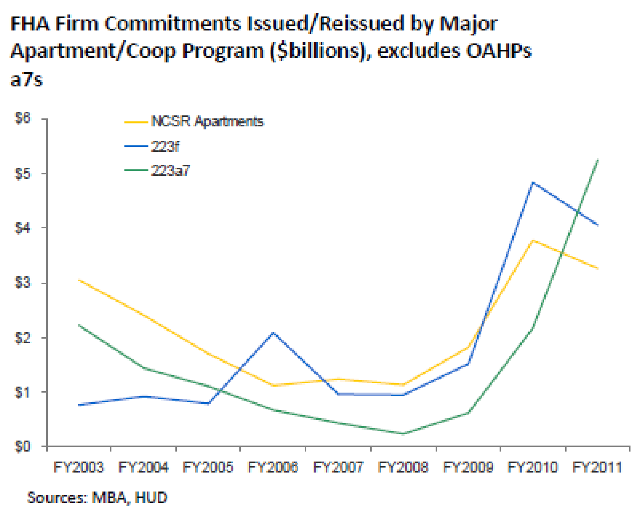
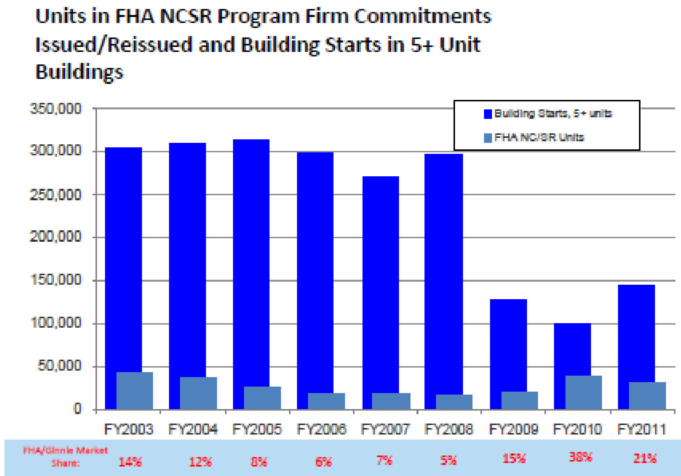


Chart 3 shows the share, in terms of units, of the multifamily new construction market that FHA occupies and demonstrates that, while the volume of multifamily lending by FHA increased from FY 2008 through 2010, both the absolute volume as well as the market share of FHA decreased in FY2011 as other investors returned to the market.

And we have recently been told by FHA staff that the new construction program volume in FY2012 is running about 10 percent behind FY2011 volumes.

Chart 3



Source: Mortgage Bankers Association, FHA and Census

FHA is an essential source of the long-term, fixed-rate debt needed to build and refinance affordable rental units for working families, seniors, and underserved populations. While FHA does provide financing for Low Income Housing Tax Credit assisted properties as well as properties with other federal or state subsidies, many of the properties financed and refinanced under the FHA multifamily programs are affordable to families at 60 to 80 percent of area median income without any type of direct subsidy. These types of properties are routinely financed by FHA-insured loans, particularly in the 223(f) and 223(a)(7) programs.

In addition, FHA financing is often used in secondary and tertiary markets. Without FHA, many of the rental housing properties that need rehabilitation would not be able to achieve the necessary capital, and new rental housing would not be able to be built. FHA insurance is also extremely important in the provision of quality and affordable seniors housing, healthcare facilities, and hospitals throughout the nation. Without the HUD healthcare programs, many communities will be stressed by a lack of affordable assisted living facilities and nursing homes. Also, HUD's own economic impact analyses on the healthcare programs states that they "demonstrate significant economic stimulus during and after construction." Nursing homes and hospitals, in particular, generate significant economic activity, both during construction or rehabilitation and post construction, with new healthcare jobs.

In addition, we believe that the HUD healthcare programs are on the front line of efforts to provide affordable healthcare. The HUD healthcare programs provide nonrated health care providers the opportunity to access capital at a cost available to borrowers with investment grade ratings. The interest savings provided by the insurance programs allows hospitals and nursing homes to spend less on interest costs and more on providing services, such as uncompensated care to the poor and elderly.

FHA's Financial Success

In 2011, the Federal Practice Group issued a study, commissioned by MBA, which provides an analysis of the net cash flow from the last two decades' experience of FHA-insured unassisted multifamily housing and nursing home mortgage loans. The loan programs analyzed in this study included Section 221(d)(4) Multifamily New Construction/Substantial Rehabilitation; Section 223(f) Multifamily Purchase/Refinance; Section 223(a)(7) Multifamily Refinance; Section 232 Nursing Home and Health Care New Construction/Substantial Rehabilitation; and Section 232 Nursing Home and Health Care Purchase/Refinance. The multifamily housing loans analyzed in the study include only unassisted loans, as defined by HUD.

The analysis involved loan-level data provided by HUD under the Freedom of Information Act on all unassisted multifamily housing and nursing home and health care facilities loan commitments made under these programs from FY1992 (when the Credit Reform Act of 1990 was implemented) through FY2010. The FOIA data were used to estimate net cash flows to the U.S. Treasury for each loan program under study, including an analysis of individual loan cohorts.

The findings of this study were:

- Overall, loans made through these programs between 1992 and 2010 have yielded positive estimated cumulative net cash flows for the U.S. Treasury of $927 million.
- Different loan cohorts have experienced different performance depending on when the loans were made and the market conditions they experienced.
- The greatest positive cumulative balance of cash flows to the U.S. Treasury has been for the Section 223(f) Multifamily Purchase/Refinance program loans, followed in declining order by Section 221(d)(4) Multifamily Development, Section 232 Nursing Home Refinance, and Section 223(a)(7) Multifamily Refinance.
- The exception is the Section 232 Nursing Home New Construction program, in which loans made during the period yielded a negative estimated cumulative balance of cash flows to the U.S. Treasury of $89 million.

These findings were derived from the analysis of historical program data and cover years of strong economic growth and, more recently, years of economic contraction. It should also be noted that HUD has significantly tightened its underwriting of healthcare loans and its risk mitigation procedures (including tightening of underwriting on specific loan sizes and types) in the multifamily programs (described more fully below). These changes should improve performance of the loans made going forward.

MBA contracted for this analysis because good data on the financial viability of the multifamily and healthcare programs is not readily available at HUD. While there is extensive data available on the income and expenses of the GI/SRI fund, this fund contains a large volume of single family loans. Congress made significant strides in separating the single family and multifamily programs in FY2009 when all new single family loans (except for Title 1 loans) were removed from the GI/SRI fund and moved to the MMI fund. However, a substantial number of single family loans originated from FY1992 to FY2009 remain in the GI/SRI fund, distorting the income and expense numbers in the fund, which many assume now only includes multifamily and healthcare loans.

MBA believes that it would be beneficial for Congress to ask HUD to separate the multifamily and healthcare loans from the single family loans in the GI/SRI data contained in the budget documents to provide Congress with a better understanding of the financial performance of the multifamily and healthcare programs.

FHA's Recent Adjustments in Light of Market Conditions

MBA applauds the leadership provided by HUD Secretary Shaun Donovan, Acting FHA Commissioner Carol Galante, and newly appointed Deputy Assistant Secretary for Multifamily Marie Head. These individuals bring extensive knowledge and experience in multifamily finance to FHA that is both refreshing and welcome. They have, over the past two years, made significant changes to the FHA multifamily programs to ensure responsible underwriting, risk management, and improved efficiencies.

In June 2010, a Mortgagee Letter was issued announcing significant tightening of the underwriting requirements for the Section 221(d)(4) new construction/substantial rehabilitation and Section 223(f) acquisition and refinancing programs. In addition to the underwriting changes, a national loan review committee was established, delegation to the field was modified, and FHA began a process of substantial credit policy and work flow management changes. HUD also has established a strong credit approach to application processing. In addition, HUD revised and tightened lender capitalization, licensing and monitoring requirements, made significant changes as part of the update of the loan closing documents, and finalized several changes to the regulations governing the FHA multifamily mortgage insurance programs.

HUD has also taken steps to mitigate risk related to large multifamily loans. In late December 2011, HUD issued a mortgagee letter regarding the underwriting of large loans, defined as those at or above $40 million. While only a small number of loans overall, HUD was concerned that a few defaults of large loans could have an overwhelming impact on the portfolio. Debt service coverage, loan-to-cost, and reserve requirements were tightened considerably for large loans (over and above the tightening already put into place). Also included in the new policy is additional scrutiny of sponsors asking for loans of $25 million or larger. Sponsors' creditworthiness, experience with large developments and past performance on FHA-insured properties are being examined much more closely before any loan applications are accepted.

Most recently, HUD has issued proposed regulations that would tighten lender and underwriter approvals and require re-approval and additional scrutiny of lenders every four years. This process is in addition to lenders' own quality control monitoring (usually performed by third party contractors) and HUD's review of lenders through their Lender Quality Monitoring Division.

All of these actions were intended to strengthen risk management practices related to the FHA multifamily mortgage insurance programs, ensure the health of the FHA multifamily portfolio and attract high-quality borrowers.

While MBA does not agree with every aspect of these actions, overall we have supported HUD's objectives and have worked to ensure that borrowers and lenders understand the changes, and we have offered suggestions for improvements in a number of areas.

These underwriting and risk mitigation processes and procedures have been instituted despite low default and claims rates on insured multifamily and healthcare loans.

Proposed MIP Increase

HUD recently issued a notice announcing increases of mortgage insurance premiums (MIPs) for certain FHA multifamily housing, health care facilities, and hospital mortgage insurance programs for commitments to be issued or reissued in FY2013.

MBA believes that any proposed increase to the MIP should be supported by data and statutory support that justify the increase. The notice does not provide compelling justification for the increases. Increasing the MIPs will not serve to build a buffer against future losses for FHA's multifamily programs, because there is no segregated fund and excess income is returned to the Treasury each year for purposes separate from these programs. The premium has been, and should continue to be, based on the management of risk to the government of the potential and severity of mortgage losses. The demonstrated strong performance of the programs, the recent implementation of processing changes to tighten credit review, improved legal documents and changes in the credit underwriting and loan requirements — all run counter to the proposed increase in the MIP.

It is important that any increase in the mortgage insurance premium be supported and preceded by a careful analysis of the need and impact of the change on these programs. HUD's notice does not provide data that supports the need for the proposed increase. In addition, ascertaining this data is difficult because the Obama administration's budget document does not account for the multifamily and healthcare programs separately; rather, they are combined with single family loans (most notably Home Equity Conversion Mortgages and loans on condominiums) that are negatively affecting the performance of the GI/SRI fund.

We believe that HUD should provide such support as part of any effort to increase fees. We also believe that any increase in fees for these programs should not be implemented at a time when demand for rental housing is increasing and preserving and investing in our stock of rental housing is critical.

FHA's Challenges and Recommendations for Strengthening FHA

MBA believes a critical requirement for achieving, sustaining and protecting the housing market's long-term vigor is ensuring that FHA has the resources it needs to operate in a modern real estate finance industry. Since 2008, HUD's multifamily staff levels have dropped significantly due to budget cuts and retirement rates. This often means that inexperienced and/or inadequately trained staff is performing key functions. HUD's multifamily staffing and training budgets have remained static or decreased, often because the needs in the single family programs have been more pressing. Technology funding has also suffered and the multifamily programs still operate without the ability to submit applications online, meaning any data must be re-keyed by HUD staff in order to process the data electronically.

With FHA volumes increasing from approximately $ 3.7 billion in FY2008 to over $12.5 billion in FY2011, FHA staff has exceeded what most thought was their maximum capacity. In order to meet the demand and provide necessary liquidity to the multifamily market, processing times have lengthened and HUD staff has been stretched to ramp up their productivity, often working long hours.

We commend HUD's recent efforts, as part of its *Breaking Ground* initiative, to improve its processes. HUD's ongoing dialogue with stakeholder partners in providing liquidity to the market has also been welcomed. While HUD has made significant progress, there is room for further improvement. For example, the process of reviewing applications hinders productivity. Rather than utilizing underwriters, as private lenders now operate, each application must be processed (usually sequentially rather than simultaneously) by a number of technical disciplines, including appraisers, architects and engineers, cost analysts, mortgage credit analysts, etc. MBA has recommended a more private sector approach to HUD's review of applications, and FHA Commissioner Carol Galante and DAS Marie Head are moving in that direction with streamlining processing of Low Income Housing Tax Credit-assisted projects. But progress is slow and the pilot program, now limited to four Hubs, should be expanded nationwide as quickly as possible. MBA believes that if HUD utilized this more streamlined process, HUD staffing levels may not need to be increased. With adequate training for staff and with improved technology, HUD could handle the current volume of business without additional staff.

Summary

FHA insurance is a vital component of the U.S. housing finance system for apartments and healthcare facilities. It is imperative that Congress and all policymakers support the multifamily and healthcare programs of FHA so that they can provide necessary liquidity and support rental housing options during the housing recovery and well into the future.

Recommendations:

- Congress should continue to provide sufficient commitment authority to FHA in order to support the multifamily and healthcare finance markets.
- Congress should encourage HUD to provide data and statutory support that justifies the MIP increase. In our view, the Notice does not provide compelling justification for the increases. Importantly, MIPs for FHA's multifamily and healthcare programs should be dedicated toward, and used solely for, these programs.
- In this regard, Congress should ask HUD to separate the multifamily and healthcare loans from the single family loans in the GI/SRI data contained in the budget documents to provide Congress with a better understanding of the financial viability of the multifamily and healthcare programs.
- Congress should provide additional support for staff training to allow new and seasoned HUD staff to upgrade their skills in underwriting, risk analysis and asset management.
- Congress should provide funding to upgrade technology to improve operational efficiencies. New technology would enable FHA to help manage risk and generally be better equipped to handle the challenges of modern markets.
- To streamline its application process, FHA should undertake a series of enhancements, such as reallocating resources, reducing inconsistency among field offices and HUD headquarters, increasing and delegating more responsibility to its field offices by increasing loan approval authority, and reducing or eliminating duplication of required information.
- HUD should continue and expand its current activities aimed at streamlining its processes and increasing the use of FHA-insured financing for projects using Low Income Housing Tax Credits.

Conclusion

MBA appreciates that FHA has been performing the countercyclical role for which it was created by ensuring a stable, liquid and affordable source of financing for multifamily housing and healthcare facilities. We look forward to working with Congress and FHA to continue striving toward the proper balance between prudent risk management practices and producing and preserving rental housing. Thank you again for the opportunity to share MBA's views.