LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS, AND GNMA IN THE SINGLE- AND MULTI-FAMILY MORTGAGE MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

OF THE

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Wednesday, May 25, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INSURANCE, HOUSING,
AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Miller of California, Capito, Garrett, McHenry, Duffy, Dold, Stivers; Gutierrez, Waters, Cleaver, Sherman, and Capuano.

Also present: Representative Green.

Chairwoman BIGGERT. This hearing of the Subcommittee on Insurance, Housing, and Community Opportunity will come to order. And I would like to welcome all the witnesses. Thank you for being here today. And I will recognize myself for my opening statement.

Good morning and welcome. Today's hearing will examine the legislative proposals to determine the future role of the Federal Housing Administration (FHA), the Rural Housing Service (RHS) and the Government National Mortgage Association (GNMA or Ginnie Mae) and the single- and multi-family mortgage markets. Our goal is to have a constructive dialogue about potential reforms to help shape a stronger framework for the future of housing finance.

Together, I hope we can better determine what role, if any, the government should play in housing finance, or should the private sector be the sole financer of housing. Is there a hybrid role for a joint private/public sector partnership? I think these are critical questions that face lawmakers on both sides of the aisle.

Today, we will examine legislative proposals that aim to stabilize the housing market, facilitate the return of private capital to housing finance, and reduce taxpayers' liabilities.

One thing that we have all learned in the wake of the financial crisis is that homeownership is not for everyone. It is also increasingly clear that buyers with a stronger financial stake in their homes are far less likely to enter foreclosure and walk away from their loans.

And finally, we have learned that the private market can't function when it is crowded by the Federal Government. The proposals under discussion today aim to encompass these lessons learned by reducing the role of government and ultimately the taxpayer, in house financing, and facilitate the return of private capital. These are sensible changes that would ensure accountability and financial stability within the FHA program.

The Administration has acknowledged that the modernization of FHA must go hand in hand with GSE reform. The goal of these reforms, as stated by the Administration, is to limit the government's primary role to "robust oversight and consumer protection, targeted assistance for low- and moderate-income homeowners and renters, and carefully design support for market stability and credit crisis response."

With that, I would just like to say that the government's role in housing finance is unsustainable. With a $14.3 trillion national debt, our country can ill-afford expansive government programs of any kind, especially when there is a private sector alternative. But the last thing we want to do is stop the recovery of the housing market. The reforms we embrace must, by every means possible, minimize disruptions to the recovery as we allow private capital to replace government capital.

As always, it is critical that we achieve the right balance for taxpayers and home buyers. I look forward to working with my colleagues on both sides of the aisle to facilitate the private sector reentry, eliminate taxpayer risk, and promote a vibrant housing finance system that serves the best interest of all Americans.

I welcome today's witnesses. And with that, I recognize Ranking Member Gutierrez for his opening statement.

Mr. GUTIERREZ. Thank you very much, Madam Chairwoman, and good morning. I want to thank our witnesses for being here today as we discuss the future of the Federal Housing Administration, the Rural Housing Service, and the Government National Mortgage Association.

There is no doubt that our districts and our communities are still reeling from our country's recent great recession. I think we can all agree that the housing market has not yet fully recovered. We need to continue working together to help American families who are literally still struggling to make ends meet and stay in their homes.

I firmly believe that our government needs to continue playing the critical role of providing homeowners with the assistance and support they need during these tough economic times while the fragile housing market recovers. And I hope that is what we are discussing today.

I want to thank Congresswoman Waters for reintroducing the FHA reform bill to improve the financial safety and soundness of the FHA mortgage insurance program. Let's not forget it was less than a year ago that my colleagues on both sides of the aisle overwhelmingly supported this exact same bill in committee and also voted for final passage on the House Floor. I hope the spirit of cooperation and collaboration still continues as we consider Congresswoman Waters' proposal.

I would like to say that I look at the Republican counterproposal and it worries me a little bit, wanting to increase the downpayment from 3½ to 5 percent. Not long ago, we all had a different point of view, and I am not quite sure what change of heart has occurred, and that we might have some further discussion on that.

FHA's market share has certainly grown in recent years, and this growth is not because FHA loosened its underwriting standards, but because the private sector has been absent from the market. I understand that my Republican colleagues would like to give entry to the private sector, but I have said it before and I will say it again, there is no assurance that private investment will take FHA's formidable place to assist qualified homeowners to purchase homes.

Right now, assistance to homeowners and potential homebuyers is key to the recovery of our housing market. We need to continue supporting the FHA, the Rural Housing Service, and Ginnie Mae and do what they do best: find ways to improve so that we can better serve current and potential homeowners and help restore a robust housing market.

I look forward to the testimony, and I thank the chairwoman for calling the hearing.

Chairwoman BIGGERT. And I thank the ranking member for his comments.

I think that is why we are here today to look at these potential drafts so that we can have a dialogue and really come up with the right process so that we can all find common ground there. I recognize Mr. Miller for 1 minute.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman.

There is no question we need to bring private capital back into the marketplace. When this happens, the role of FHA will be reduced automatically. We have seen this historically, that FHA plays a countercylical partner role. But the worst thing we can do today to create a lack of stability in the marketplace is to reduce those loan limits in this marketplace. Some of the best loans they are making are in high-cost areas. Conforming and high-cost GSEs and FHA are providing 92 percent of all the liquidity in the marketplace. If the private sector dollar was there today to backfill that, that is an argument some could make. But it is not there. To say it is, you would have to show me where it is at, because it is not. And if you want to create more instability in the marketplace, start modifying the loan limits that we have downwardly, and it will have a tremendously negative impact.

I am glad this is just a discussion draft. We need to be very, very cautious in what we are doing. If you want to hurt buyers and sellers, who are taxpayers in this country, you will start messing with the system we have today that is doing nothing but trying to stabilize a very distressed marketplace. If you don't understand how distressed it is, talk to builders, REALTORS®, mortgage brokers, and bankers, and they will tell you how bad it is. Talk to the people out there in the marketplace who have lost tremendous amounts of equity in their home. And when you have a lesser amount of liquidity in the marketplace and fewer lenders willing to make loans and you want to sell a house, the value of your house is going to drop dramatically.

So I am glad this is a discussion draft. We need to move very cautiously and very carefully. We have a tremendously impacted marketplace. Let's not do something knee-jerk that is going to make it more difficult.

I yield back. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. The gentlelady from California, Ms. Waters, is recognized for 2 minutes.

Ms. WATERS. Thank you very much. Madam Chairwoman, I would like to thank you for holding this hearing on the future of FHA, the Rural Housing Service, and Ginnie Mae. FHA's role has grown more significant in the years following the financial crisis of 2008, providing a crucial backdrop in our mortgage market and ensuring continued access to safe and affordable products while the private market constricted.

Of course, with this increased role, it is appropriate to increase oversight and scrutiny of FHA. That is why FHA was one of my top priorities when I chaired the Housing and Community Opportunity Subcommittee during the last Congress.

In order to continue my work from the 111th Congress, yesterday I reintroduced the FHA Reform Act. Last year, I was able to work well with then-Ranking Member Capito on an FHA bill that overwhelmingly passed the House on a bipartisan basis. I hope that I can work with Chairwoman Biggert in a similar fashion in the 112th Congress.

I would like to note, however, a few concerns with the FHA discussion draft that we are considering at this hearing today. This discussion draft would increase downpayments, a move that was overwhelmingly rejected in committee markup last year on a bipartisan basis. The rationale for this rejection was because FHA data demonstrated that increasing downpayments across-the-board would do little to improve FHA's reserves, while also restricting credit to qualified borrowers. I think that allowing FHA to manage risk in a flexible manner is the best way to continue to protect their reserves.

Additionally, I strongly oppose the rapid reduction in FHA loan limits proposed in this bill, as I believe that decrease would have an absolutely chilling impact on our economic recovery. And unfortunately, because of the elimination of the nationwide loan limit floor, this impact would likely be felt the hardest in places where home prices are already low.

Finally, I think there are major problems with moving rural housing programs to HUD. And I am very interested to hear the testimony from the rural advocates here today.

So Madam Chairwoman, I think there are some areas for agreement. I hope we can work together in the coming months, but I remain very concerned about several of the provisions in this bill.

Thank you, and I yield back the balance of my time.

Chairwoman BIGGERT. Thank you very much. And I am sure we can find some common ground.

The gentlelady from West Virginia, Mrs. Capito, is recognized for 1 minute.

Mrs. CAPITO. Thank you. I would like to thank Chairwoman Biggert and the ranking member for having the hearing. I would like to thank the witnesses as well.

As we have heard, we know this is of critical importance for us to restore our overall housing market, and I am particularly interested in hearing about the proposals that are set forth in the draft legislation.

As has been discussed many times previously, we worked on FHA reform last year, and got it all the way through the House on a bipartisan basis. We know that FHA will play an important role in the housing market by providing stability and liquidity.

This has not been the case for the last several years, however. As mortgage defaults begin to mount when the Federal Government insured and guaranteed 9 out of every 10 new mortgages, FHA lost some of its financial footing. Capital reserves fell well below federally mandated levels and I think that has the possibility of putting our taxpayers at risk, which is what this hearing is about today.

So I know fundamental reforms have already been moving forward, and I am pleased about that, but I believe we still have obstacles remaining where we can't get the private market in, as Congressman Miller was talking about.

I look forward to hearing from our witnesses on the advantages and disadvantages of the discussion draft. And I am also interested on the RHS, moving RHS out of the Department of Agriculture.

And with that, I yield back the time I don't have.

Chairwoman BIGGERT. Thank you very much.

The gentleman from New Jersey, Mr. Garrett, is recognized for 1 minute.

Mr. GARRETT. I thank the Chair for all your hard work, for your thoughtful work on this legislative draft that we have before us, because reforming the FHA is of critical importance and should be a top priority of this committee. And the draft before us, as indicated, has a number of good proposals in it that should add to the safety and soundness of the FHA, and also protect taxpayers in possible future losses.

And one provision that I believe is in fact a positive is the downpayment increase from 3½ to 5 percent. A lot of you know I sponsored legislation in the past Congress to do exactly that. I believe it is significant, but really just a modest step in the right direction to ensure borrowers have what we have been talking about, real skin in the game. LTV, loan to value ratio, is an important component. It is not the only one. But going to 5 percent is a far cry from what the QRM is talking about in that area of around 20 percent in their draft rules.

Today, the FHA insures roughly 50 percent of new originations in the United States. This is really an astronomical number compared to pre-crisis stage, and as we begin to reduce the footprint of them, of FHA and the government more broadly, we have to get the private market back into the game.

And with that, I too yield back the time that I do not have.

Chairwoman BIGGERT. I thank the gentleman.

At this time, I ask unanimous consent that the gentleman from Texas, Mr. Green, a member of the full Financial Services Committee, be allowed to participate in the hearing. He is recognized for 1 minute.

Mr. GREEN. Thank you very much. Madam Chairwoman, and thank you, Mr. Ranking Member, for allowing me the opportunity to speak for just a moment.

I am concerned about the increase of the downpayment from 3.5 percent to 5 percent for many persons, not all, but many persons, who have never had a home; for many persons, not all, who have never had a home. The home itself is skin in the game. They finally get a place to call home. That is skin in the game. Keeping that home, for them, is keeping something that is a dream come true. That is skin in the game for them; for many people, not all.

So my hope is that we will understand that there are plenty of people out there, good, hardworking American citizens, who can afford a monthly payment, who will consider the home skin in the game, who can't afford a downpayment as high as we might move it to.

Commissioner Stevens has indicated that this might cause as many as 300,000 fewer homes to get financed. So my hope is that we will strike a balance, that we will make sure that those who can afford rent that would be higher than a mortgage payment can get the mortgage payment and have skin in the game; namely, a place to call home.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. I thank the gentleman.

I would now like to again welcome the witnesses. And, without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony.

Let me just introduce you all. First, we have Ms. Katherine Alitz, senior vice president, Boston Capital, on behalf of the Council for Affordable and Rural Housing. Next, is Mr. Michael D. Berman, chairman, Mortgage Bankers Association, followed by Dr. Mark A Calabria, director of financial regulation studies, Cato Institute, Washington, D.C.

I don't think we have ever had a panel this big. There are a lot of names here.

Mr. Peter Carey, president and CEO, Self-Help Enterprises, on behalf of the Housing Assistance Council and the National Rural Housing Coalition; Mr. Brian Chappelle, partner, Potomac Partners; Mr. Peter W. Evans, partner, Moran and Company, on behalf of the National Multi Housing Council and the National Apartment Association; Mr. Basil Petrou, managing partner, Federal Financial Analytics, Inc.; Mr. Ron Phipps, broker, Phipps Realty, on behalf of the National Association of REALTORS®; and Mr. Barry Rutenberg, first vice chairman, National Association of Home Builders.

Welcome, all of you. Now, we will recognize each of you for 5 minutes.

And we will start with Ms. Alitz. You may begin.

STATEMENT OF KATHERINE M. ALITZ, SENIOR VICE PRESIDENT, BOSTON CAPITAL, ON BEHALF OF THE COUNCIL FOR AFFORDABLE AND RURAL HOUSING (CARH)

Ms. ALITZ. Thank you, Madam Chairwoman. I am the president of the Council for Affordable and Rural Housing, and on behalf of myself and CARH, I want to thank the committee for the opportunity today to testify about the importance of Federal rural housing programs, the need to support these programs, and to address the draft legislation.

CARH members house hundreds of thousands of low-income, elderly, and disabled residents in rural America. CARH has sought to promote the development and preservation of affordable rural housing throughout its 30-year history as an association of for-profit companies, nonprofit companies, and public agencies that together build, own, manage, and invest in rural affordable housing.

My comments will address the later portions of the draft legislation which concern rural housing. CARH is very much focused on saving from elimination the Section 538 Guaranteed Rural Rental Housing Program. Section 14 of the draft legislation proposes a fee-based system to continue the 538 program. We hope the much-needed 538 program provisions move forward with all due speed, as many development projects and the housing and jobs they create are waiting to proceed.

CARH also appreciates the interest in streamlining Federal housing program administration. At the same time, the different housing agencies did not develop arbitrarily, but rather in response to different housing needs. Any consolidation of functions must address these different constituencies.

CARH members continue to review the issue because there are pros and cons. The notion of moving some parts of rural development to HUD has been a topic of discussion in the past. However, the draft legislation circulated in advance of this hearing is the first serious legislative proposal we can recall regarding this issue.

Before moving forward, we believe it merits further discussion among the housing industry and the affected authorizing and appropriating committees. It is important to ensure that whatever the context, certain programs continue and budget support remains for these programs.

In rural America, the key rental housing programs have been and remain the rural development multi-family programs. The Administration's Fiscal Year 2012 budget request is notable in that it eliminates the Section 538 programs, even though the 538 program is one of the most successful and low-cost programs currently used by rural development. CARH strongly supports maintaining a program level of $129 million.

Further, we believe the 538 program can be rendered revenue-neutral, or virtually so, by allowing for a fee to be charged. The Section 538 statute already provides USDA with the discretion to charge a fee, but appropriations language has prohibited rural development from charging fees.

CARH strongly supports Section 14 of the draft legislation. By incorporating fees, this section would restore financial balance to the program, while saving Federal appropriations.

The Section 521 Rental Assistance Program is a lifeline for extremely low-income rural residents. Section 521 is similar to HUD's Section 8 program. The Administration's Fiscal Year 2012 budget reduces rental assistance funding to $907 million. This is an unsustainable reduction which may result in the loss of housing for residents living in several hundred apartment complexes in rural America.

Rural development has openly discussed how it anticipates achieving this by reducing the number of our rental assistance recipients through foreclosure of certain targeted Section 515 loans, or by pressing for the payment of other 515 loans.

To avoid the dislocation of residents, CARH urges full funding of rental assistance for Fiscal Year 2012 at the Fiscal Year 2010 level of $971 million.

To the extent that Congress looks to pass rental assistance funding levels, we believe it is important to explain that rental assistance budgets have not increased in any real sense, although the budget amount has increased. For approximately the past 5 years, Congress has sought to convert rental assistance contracts from multi-year allocations to single-year allocations because this creates a short-term budget savings.

Since Fiscal Year 2009, rental assistance contracts between rural development and property owners have been for 1-year terms. So, for example, if Congress decides to look back to Fiscal Year 2008 funding levels without adjusting for these budget changes, it may unwittingly dislocate over 100,000 residents.

Time constraints permit me from talking about every topic included in our written testimony, so I refer the committee to that testimony for more on the Section 515 program and the elimination of the MPR program in the Fiscal Year 2012 budget.

We appreciate the committee's efforts to balance the needs of rural America's elderly, disabled, and working poor with our ongoing budget issues. The rural programs have been and remain our most efficient Federal housing, Federal rental housing programs, and are a resource that rural America cannot afford to lose. Thank you.

[The prepared statement of Ms. Alitz can be found on page 44 of the appendix.]

Chairwoman BIGGERT. Thank you very much—

Mr. Berman, you are recognized for 5 minutes.

STATEMENT OF MICHAEL D. BERMAN, CMB, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. BERMAN. Thank you, Chairwoman Biggert.

FHA is at an important crossroads today, and this hearing occurring in the midst of efforts to reshape our housing financial system is especially timely. A few years ago, a growing number of voices were asking whether there was still a need for FHA or if the private market could fully absorb its functions.

MBA never wavered in its support for the critical mission FHA performs, and the last few years have underscored that point many times over. Today, FHA is performing its traditional countercylical role, increasing its market share from 3 to 30 percent, and providing necessary liquidity to our otherwise frozen housing finance sector. In doing so, it is ensuring access to safe mortgage products, helping homeowners to refinance into more affordable interest rates, and supporting the growing need for decent, affordable rental housing.

We should all be grateful FHA is here today, and this subcommittee deserves recognition for the bipartisan focus it has put on FHA. Recent Congresses have made important changes to loan limits, given FHA more flexibility to set insurance premiums, and eliminated the failed, seller-funded downpayment assistance program, and provided FHA with additional staffing and technology upgrades. Thanks to your efforts, FHA is not only serving an expanded segment of the market during this economic downturn, but doing so while remaining in the black, an amazing feat, considering the impacts the foreclosure crisis has had on other market participants.

While MBA's full recommendations are in our submitted statement, I would like to highlight the effect of two pending proposals on FHA. First, MBA members are deeply concerned with the proposed risk retention rule, its narrowly written competition for qualified residential mortgages and the ultimate effect it would have on FHA. The proposed QRM definition appears to conflict directly with the Obama Administration's preference for shrinking FHA from its current role of financing nearly one-third of all mortgages. It is not at all clear whether regulators reflected on the relationship between the proposed QRM definition and FHA's eligibility requirements in light of FHA's exemption from risk retention.

By making it even more difficult for private capital to reenter the housing finance market, the QRM rule would lead FHA to being flooded with even more, not fewer, loans. And while FHA has an important role to play, MBA firmly believes that it is not in the public interest for a government insurance program to dominate the market. One of our primary concerns about the proposed QRM rule is the overemphasis on downpayment as an indicator of a risky loan.

Likewise, we have similar apprehension about the legislation to raise FHA's minimum downpayment to 5 percent. We should not be placing such a high emphasis on just one factor in determining a loan product's overall risk. While downpayment has an important impact on default, other factors, including full documentation of income and borrower credit, can mitigate this risk. In fact, it is FHA's requirement for full documentation of all loans and its limited product options that helped insulate it from experiencing a more devastating default rate during the height of the housing crisis.

MBA's most recent national delinquency survey, which we just released last week, drives this point home. The data found that for the first quarter of 2011, the FHA delinquency rate is down a full percentage point relative to last year, and the foreclosure start rate is down about 50 basis points. Policymakers need to carefully weigh their desire to decrease risk by raising minimum downpayments versus the certain and dramatic negative impact such a change would have on the availability of loans to low- to moderate-income, first-time, and minority home buyers.

I would also like to touch on the proposals to lower FHA loan limits. Intense focus has been placed on the narrow slice of loans at the high end of the spectrum. MBA understands that those maximum loan limits are likely to go down to $625,000 on October 1st, but we think it would also be a mistake, and a mistake to also lower the limits in low-cost areas where FHA does most of its business. The average new FHA loan is about $190,000. In places like Texas, Georgia, and North Carolina, reducing or eliminating FHA's floor of $271,000 would drastically deny access to credit for many otherwise qualified lower- and middle-income borrowers. We need to be very cautious in enacting these proposals, given the continued weak state of the housing market.

Finally, as a multi-family lender, I would like to note that FHA's statutory limits for multi-family housing are severely restricting the ability of rental property owners in urban markets to use FHA insurance programs. These limits can have an especially adverse effect on seniors, and should be addressed by Congress.

Further, given the backlog of loans in the FHA multi-family arena, it is important that Congress encourage FHA to create operational efficiencies without political constraints.

Madam Chairwoman, thank you for the opportunity to testify today.

[The prepared statement of Mr. Berman can be found on page 50 of the appendix.]

Chairwoman BIGGERT. Thank you very much, Mr. Berman.

And now, Mr. Calabria for 5 minutes.

STATEMENT OF MARK A. CALABRIA, Ph.D., DIRECTOR OF FINANCIAL REGULATION STUDIES, CATO INSTITUTE, WASHINGTON, D.C.

Mr. CALABRIA. Since the end of 2007, FHA reserves have declined from $22 billion to currently around $3.5 billion. While of course some decline is to be expected, given the bursting of the housing bubble and the continued weakness in the labor market, further declines could easily erode the remaining reserves and require a direct appropriation to cover future claims.

The potential for a bailout of FHA remains not a remote possibility. According to the 2010 Actuarial Review, the net present value of future cash flows from FHA's current book of business is a negative $25.4 billion. The Actuarial Review projects a positive value for FHA on the basis of assuming that future business will generate revenue sufficient to cover embedded losses. In order for that assumption to turn out correct and to protect us from a bailout of FHA, credit quality of FHA lending standards must improve considerably.

The estimated positive value of FHA's single-family business is also predicated upon stability in house prices. The most recent actuarial review from which the current positive values derive also gives a 40 percent chance that the true value of the fund is negative. We are essentially at the point of tossing a coin to determine the value of FHA, whether it is negative or positive.

To improve the stability of FHA, I think we need to take a number of recommendations. Prior to giving those recommendations, however, I think we should start from maybe what I think is the most important observation of the financial crisis, which is, if lenders, borrowers, investors and governments do not face the actual cost of their decisions, those decisions are likely to have negative consequences.

For at least three reasons, FHA's current premiums do not reflect its true cost. First among those is FHA's administrative costs are not covered by premiums but are covered by direct appropriations. A program can hardly claim to pay for itself when a very large portion of its costs are directly appropriated by the taxpayers. Going forward, I urge that premiums be structured in a way to cover FHA's administrative costs.

Since FHA's premiums do not reflect any market risk, that risk is also not accounted for. CBO estimates that this admission distorts FHA's true costs by billions annually.

Just as Congress, this body, required TARP to reflect market risk, FHA should reflect market risk and should be estimated on a fair-value basis.

Lastly, FHA has a poor track record in estimating its own subsidies, even under the flawed framework of the Credit Reform Act. Over the last decade, FHA subsidy estimates were off by a net total of $44 billion, turning all of the supposed negative subsidies into actual subsidies over the last decade. These errors have always been biased in the direction of underestimating cost and must be addressed in order for both Congress and FHA to appropriately manage FHA's risks.

Going forward, I think we need to make a variety of changes. First and foremost, I believe we need to change the incentive of FHA-participating lenders. The incentive for diligent and thorough underwriting is in my opinion simply too weak under existing procedures.

First of all, we should immediately reduce FHA's coverage from 100 percent of the loan to 80 percent of the loan. Any mortgage that goes 100 percent bad is likely to involve fraud or negligence. Private mortgage insurance rarely covers more than 30 percent of the value of the loan. Other Federal guarantee programs, such as those under SBA, function quite well without covering 100 percent of the risk. As the lender is in the best position to monitor risk, the lender should also be required to maintain a portion of that risk under FHA. FHA should also put back to the lender any loan that defaults within 6 months of origination. Mortgages that go sour so quickly also are likely to have involved fraud or negligence.

FHA should also end the practice of letting the lender choose the appraisal. We should go back to the practice that was prior to the mid-1990s where you had an appraisal practice that ensured appraisal independence. Changing lender incentives, while vital, will not be sufficient, in my opinion, to reduce continued losses in FHA. Significant changes to borrower eligibility must be implemented.

As I document in my written testimony, the worst losses in FHA, as well as mortgage lending in general, come from a combination of poor credit history and loan downpayment. You could manage either manageably, but you cannot combine the two without resulting in significant losses. To manage this risk, I recommend that FHA immediately require an all-cash downpayment of at least 5 percent from all borrowers.

We also know that high debt burdens can contribute to default. FHA should accordingly guarantee loans with only reasonable debt-to-income ratios. It should tell us something that you can get a new FHA loan today and be immediately eligible for a modification under HAMP. Other programs, for instance, such as 31 percent is deemed a reasonable debt-to-income under HAMP, then it strikes me as a reasonable debt-to-income for FHA.

Borrower eligibility income should also be changed so that FHA mirrors the Rural Housing Service, and that borrowers with incomes at or below 115 percent with AMI are eligible for FHA guarantees. I would go as far as to say we should just simply scrap the whole loan limit framework and base FHA on income, as we do in the rural housing program.

With that, I will wrap up my statements and look forward to questions.

[The prepared statement of Dr. Calabria can be found on page 63 of the appendix.]

Chairwoman BIGGERT. Thank you very much, Mr. Calabria. I am trying to get these names.

Mr. CALABRIA. You are doing quite well.

Chairwoman BIGGERT. Thank you.

Mr. Carey, you are recognized for 5 minutes.

STATEMENT OF PETER CAREY, PRESIDENT AND CEO, SELF-HELP ENTERPRISES, ON BEHALF OF THE HOUSING ASSISTANCE COUNCIL (HAC) AND THE NATIONAL RURAL HOUSING COALITION (NRHC)

Mr. CAREY. Thank you, Chairwoman Biggert. I appreciate the opportunity to be here today to testify specifically on the proposed transfer of rural housing programs to HUD. I am Peter Carey, president of Self-Help Enterprises, a regional and nonprofit housing development organization serving California's agricultural San Joaquin Valley. And I am representing the Housing Assistance Council and the National Rural Housing Coalition.

The draft bill before the subcommittee would move the entire lock, stock, and barrel housing programs of Rural Housing Services to the Department of Housing and Urban Development with the intent of improving service delivery to rural America. Four decades of hands-on rural housing experience at the three organizations I represent are confident such a move would not improve the administration of rural housing programs, would not help accomplish the mission Congress established them to deliver, and would make it more difficult for USDA to deliver its comprehensive rural development programs effectively.

There is no time to go into the details today, but suffice it to say that Rural Housing Services is a remarkably successful, long-term mortgage provider, both for rental housing and for homeownership in rural America. Most of RHS' service goes to small communities, primarily communities under 10,000 in population.

The Rural Housing Service is certainly not perfect, and USDA's attention to housing could certainly be improved, but moving the rural housing programs from one department to another would not address those problems and would create significant additional challenges for service delivery.

While there are concerns about USDA's attention to housing, we have equally grave concerns that HUD's structure is not set up to deliver Title 5 programs. HUD has limited experience in administering programs directed exclusively to rural areas. Most of HUD's programs can be used in rural areas, because their lack of context are delivered through State agencies, and the HUD Department structure is primarily urban-based. And historically, statistics show that home, CDBG, and FHA have spent a lower proportion of their funds in rural areas than the populations living there.

HUD has never had a direct homeownership lending program like the Section 502 direct loan program and does not make direct loans to rental developers. HUD's experience, frankly, is in delivering block grants, guarantees, rental subsidies, not mortgage loans. It works through local, State, and tribal governments; developers; banks; intermediaries; and public housing authorities.

In short, while the loans and grants offered by the Title 5 rural housing programs are really retail items, HUD is a wholesaler, not a retailer.

HUD's office infrastructure is not well suited to rural delivery. In my own State of California, there are six metropolitan HUD offices, where USDA has 18 local offices. I can get to discuss programs with a rural development staff person within about 10 minutes. It is a 250-mile drive to San Francisco or Los Angeles to have the same conversation with HUD, and the same is true for rural borrowers and others.

The difference is even more dramatic in States with fewer large urban centers. In Illinois, for instance, HUD has 2 offices, while Rural Development has 12 offices.

The retail nature of Title 5 programs would require HUD to shift dramatically the way it does business. It is much more likely that the rural housing programs would be force-fit into the HUD delivery system. That would change the ability of those programs to reach rural communities. The dollar amount is not significant enough. It would represent about 5 percent of HUD's budget, and would not be significant enough to change the way HUD could deliver those programs.

At USDA, it is important to realize that housing programs are interwoven with other mission areas, rural community facilities, rural businesses and cooperatives, rural utilities. They represent all facets of rural development in California and other rural areas. Removing those programs would complicate USDA's ability to deliver those rural development programs. And in many cases, those offices are co-located with Farm Service Administration, Soil Conversation, and others, creating a very comprehensive presence in rural America that is unmatched, even by State governments.

The cost in money and human capital to make such a move is mind-boggling. Six hundred people and the attached infrastructure would be moved to HUD with, we believe, little to gain.

There is no doubt that HRS can and should do better. There is also no doubt in our minds that HUD lacks the administrative system to deliver effective rural programs. Its programs, constituency, and interests lie elsewhere.

Self-Help Enterprises, the Housing Assistance Council, and the National Rural Housing Coalition and hundreds of other rural housing organizations around the country would be happy to work with this committee and the subcommittee to identify less expensive, more effective ways to address RHS' shortcomings and maximize its capabilities. Thank you.

[The prepared statement of Mr. Carey can be found on page 72 of the appendix.]

Chairwoman BIGGERT. Thank you very much, Mr. Carey.

And Mr. Chappelle, you are recognized for 5 minutes.

STATEMENT OF BRIAN CHAPPELLE, PARTNER, POTOMAC PARTNERS LLC

Mr. CHAPPELLE. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. I am Brian Chappelle.

I would first like to review FHA's key tenets and current performance. FHA, at its core, is an insurance program, and like any successful insurance program it needs to spread its risk. Just like an auto insurer could not be limited to drivers under the age of 25, FHA cannot be targeted only to high-risk borrowers.

FHA has an even more daunting task, however, than your typical insurer. Its mission is to serve borrowers not adequately served by the private sector and still operate at no expense to the American taxpayer. As if those goals weren't enough, FHA is asked to accomplish them without encroaching on the private sector.

Finally, it was asked to increase its role in 2007 when others were running away from the market.

So how is FHA doing?

First and foremost, we are 4 years removed from the collapse of the housing market, and FHA hasn't needed any taxpayer assistance. In fact, according to Secretary Donovan's testimony last month, its cash reserves were at a historical high in 2009, and grew again in 2010.

At the hearing, Secretary Donovan also said that they expect FHA to make substantially more money for the taxpayer this year than their actuary predicted. This means that FHA's net worth, including expenses, should more than double in Fiscal Year 2011 to over $11 billion.

In MBA's latest delinquency survey, FHA was the only market segment that saw its total delinquency rate fall in the first quarter of 2011. It is now at the lowest level in 5 years. Its credit quality is the best in decades, as about 60 percent of its borrowers have credit scores higher than 680, and only 3 percent have credit scores below 620.

Not surprisingly, the loans that FHA has insured in the last 2½ years have very low rates of delinquency. A couple of statistics to underscore this point: The early default rates in the FHA program have declined 85 percent from 2007 to 2010. Of the 1.4 million loans that FHA made last year, only 5,000 of 1.4 million loans are currently in default. Clearly, fraud and poor underwriting are being rooted out of the FHA program.

In the wake of the housing crisis, FHA has helped millions of families from all walks of life. Still, FHA has maintained its core role of helping the underserved.

According to 2009 HMDA data, the government insured 65 percent of the loans made to low- and moderate-income families and 75 percent of the loans made to minority home buyers. So how is FHA doing it?

The Congress eliminated seller-funded downpayments in 2008. Without these loans, FHA would be over the 2 percent capital ratio today.

Secretary Donovan and his team moved quickly on a variety of fronts to ensure FHA's long-term solvency, including strong enforcement actions that have reverberated throughout the industry.

While it may not be popular to give lenders any credit in this process, it is a fact that starting in 2008, lenders implemented their own underwriting restrictions on top of FHA requirements. With these credit overlays, as they are called, lenders in effect are saying they are unwilling to originate certain loans that meet government criteria because of the contingent liability. Why would lenders do this when there is 100 percent government backing of these loans?

Mortgage lenders have skin in the game and in the FHA program. They have financial risk, have enforcement risk, and probably most importantly, have reputation risk. Lenders are using credit overlays to manage these risks.

Finally, I have comments on two of the proposals. I would support raising downpayments if it were necessary to protect the fund. However, the performance data does not support it and it would hurt the very people who need FHA the most.

Regarding the reduction in the mortgage limits, I oppose this provision since it would jeopardize FHA's financial strength. It has been a cornerstone of the FHA program that higher-balance loans perform better than lower-balance ones. This point has been made in every recent audit, including the Fiscal Year 2010 audit.

In conclusion, any additional targeting in the FHA program will increase premiums to FHA borrowers and increase risk to the American taxpayer.

Thank you, and I would be glad to answer any questions.

[The prepared statement of Mr. Chappelle can be found on page 78 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Chappelle.

Mr. Evans from Illinois, you are recognized for 5 minutes.

STATEMENT OF PETER W. EVANS, PARTNER, MORAN & COMPANY, ON BEHALF OF THE NATIONAL MULTI HOUSING COUNCIL (NMHC) AND THE NATIONAL APARTMENT ASSOCIATION (NAA)

Mr. EVANS. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. On behalf of this Nation's 17 million households who call an apartment their home, thank you for the opportunity to testify on the role of FHA and Ginnie Mae in the multi-family industry.

I am Peter Evans, a partner at Moran & Company. We specialize in developing, acquiring, and financing apartments, and we use FHA's multi-family mortgage insurance programs to finance both conventional and affordable rental housing. I am testifying on behalf of the National Multi Housing Council and the National Apartment Association. NMHC and NAA work together to represent the full spectrum of the Nation's apartment industry.

Before I offer my comments on FHA and Ginnie Mae, I want to first give some perspective on the growing importance of rental housing in our society.

The United States is truly on the cusp of a fundamental change in our housing dynamics. For demographic, financial, and lifestyle reasons, rental demand is surging. In this decade, renters can make up half of all new households. I want to reiterate that point: Half of all new households, for a total of more than seven million new households.

But supply is falling short of demand. We need to build 300,000 units a year to meet demand, yet we will start fewer than half of that this year. That demand and our industry's capacity to meet it is why today's hearing on FHA is so important.

FHA has always been an important capital provider for the industry, admirably filling a specific market. But during the financial crisis, it became one of the few remaining sources of liquidity for our industry. Demand for FHA financing has increased more than fivefold. Applications have increased from 2 billion to 10 billion, and HUD anticipates that demand will continue for the next couple of years.

FHA has had a hard time keeping up with this demand, unfortunately. Loan processing times can now exceed 18 to 24 months, and many borrowers have no idea where in the pipeline their applications are. This has resulted in an enormous backlog that is preventing our industry from meeting the Nation's growing demand for rental housing. We strongly support FHA's efforts to maintain sound credit and underwriting policies, but the resulting bottleneck is jeopardizing the thousands of jobs created by the multi-family construction, not to mention the net revenues and profits the Agency's multi-family program generates for the Federal Government.

We offer the following recommendations to improve FHA's ability to serve the multi-family marketplace, which includes some items that HUD and FHA have already identified:

Follow the multi-family accelerated process guide to ensure loans are processed efficiently and adhere to the time lines within that guide:

Seek a more efficient means to address credit concerns. For instance, FHA requires all loans over $15 million to be processed by a national loan committee instead of the field office. Instead of using a dollar limit, FHA should only require centralized review of the loans that exceed the program's terms and requirements.

FHA should also establish a special underwriting team for large atypical loans, expediting the process of more standard transactions.

Provide greater oversight over market assessment data information. Better manage multi-family resources with no additional costs such as exempting high-performing offices from having the national loan committee review certain types of transactions that present little risk to the taxpayer.

The committee has asked us to comment on its discussion draft of FHA reform legislation. While the bill is primarily focused on single-family and rural housing, there are two very important multi-family issues that we would like to address. We would urge you to add a provision to the bill raising the FHA loan limits for high-rise elevator properties, because the current limits are too low to allow FHA financing to be used in urban areas where affordable and work force housing shortages are often most severe. Last year the House passed bipartisan legislation to do just that.

We also appreciate the committee's efforts to improve the long-term viability of the FHA multi-family programs by implementing a risk-based capital reserve. We oppose, however, increasing the mortgage insurance premium for lower-risk loan programs to subsidize higher-risk FHA insurance activities. Raising multi-family premiums to subsidize losses in other programs could have a chilling effect on rental housing production.

And finally, I would like to address suggestions that FHA replace or take over Fannie Mae and Freddie Mac's multi-family programs. We strongly oppose such efforts. As we have noted, FHA is unprepared to assume a larger role. In addition to the capacity issues identified, it is important to understand that FHA serves a specific niche within the market. It is simply not capable of providing a full range of unique and complex loans required by the apartment sector.

NMHC and NAA look forward to working with you on reforming our housing financial system in a way that ensures a robust and uninterrupted supply of capital is available to ensure our Nation's work force housing needs are met.

Thank you again for the opportunity to testify.

[The prepared statement of Mr. Evans can be found on page 99 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Evans.

And, Mr. Petrou, you are recognized for 5 minutes.

STATEMENT OF BASIL N. PETROU, MANAGING PARTNER, FEDERAL FINANCIAL ANALYTICS, INC.

Mr. PETROU. Thank you, Madam Chairwoman. I commend the subcommittee for its attention to the important question of FHA and Ginnie Mae reform, but this legislation must be seen in the larger context of both ensuring the return of private capital to the U.S. mortgage finance system and balancing reform of FHA and Ginnie Mae with the reform of the GSEs.

I want to second the concern that has been raised this morning with the qualified residential mortgage definition as it is being proposed by the banking agency. Because the law exempts FHA, and the proposed rule would impose stringent risk retention requirements on all mortgages with downpayments of less than 20 percent, low downpayment lending will flow to FHA, unnecessarily increasing taxpayer risk.

Congress and the Administration are correct in focusing on winding down the GSEs in concert with changes to the FHA so that the U.S. residential mortgage secondary market does not become the sole province of entities backed directly or indirectly by the taxpayer.

The draft legislation considered today is a vital first step towards a newly rebalanced policy in mortgage finance. Key provisions in it that I support include:

First, the increase in the minimum borrower downpayment to 5 percent which, when combined with a prohibition against the financing of closing costs, will increase the skin in the game contributed by borrowers. In a world of unstable house prices, beginning ownership with the bare minimum 3½ percent equity interest in a house means that the borrower is vulnerable to even relatively slight house price reductions. If house prices fall, first-time buyers will see their equity wiped out very quickly. This is highly problematic for borrowers, their communities, and the solvency of the U.S. mortgage finance system.

Second, the revised approach to setting area loan limit amounts and, in particular, elimination of the FHA national loan limit floor. Home prices have fallen across most of the country in the past few years. And the current FHA national loan limit floor is at least 60 percent higher than the national median existing house price. This undermines FHA's missions of targeting low- and moderate-income borrowers, permitting the United States to back borrowers with the highest incomes in their local areas.

Third, the establishment of minimum FHA mortgage insurance premiums is essential to rebuilding the solvency of the FHA, and thus to reducing taxpayer risk.

Finally, I support improvements in the powers of the FHA to terminate or discipline lenders and to require indemnification from them. As long as FHA continues its current structure of direct endorsement lending and 100 percent Federal guarantee, the MMI fund will be faced with a misalignment of incentives for FHA lenders. The measures proposed in this legislation will help protect the U.S. taxpayer.

I would like to suggest to the committee additional legislative changes which would allow FHA to initiate pilot programs to test the best way to alter its future activities to serve borrowers while protecting taxpayers.

First, instead of targeting house prices, the FHA should be allowed to target borrower income as it relates to the median family income in an area. This approach would limit gaming of the FHA loan limits in future years as median family income fluctuates far less than median house price over time.

Second, FHA should insure less than 100 percent of the loan amount. The MMI fund would be far healthier over time if lenders were required to have more skin in the game. The current VA program is an example where less than 100 percent coverage is currently implemented with Ginnie Mae. Congress could have FHA insure 30 percent of a loan amount in areas where there is already a high homeownership rate and where borrower incomes are sufficient to meet housing needs. But where homeownership is low and house prices are uncertain, FHA could insure 85 percent of the loan amount to provide lenders with an incentive to advance funding.

Finally, FHA should experiment with risk-sharing programs with private capital. For example, FHA has the authority to enter into a risk-share pilot program with private insurers, but this authority should be amended to allow risk-sharing where the private insurer takes a first-loss position and the FHA assumes a second-loss one. This approach would significantly reduce taxpayer risk due to the direct risk absorption provided by private capital and through the benefit of an independent second underwriting of the loan.

I want to commend the subcommittee for this important reform bill. Thank you.

[The prepared statement of Mr. Petrou can be found on page 114 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Phipps, you are recognized for 5 minutes.

STATEMENT OF RON PHIPPS, BROKER, PHIPPS REALTY, AND PRESIDENT, NATIONAL ASSOCIATION OF REALTORS® (NAR)

Mr. PHIPPS. Good morning, Madam Chairwoman, Ranking Member Gutierrez, and members of the subcommittee. My name is Ron Phipps, and I am the 2011 President of the National Association of REALTORS®. I am also an active part of a four-generation, family-owned residential real estate business in Rhode Island, and I am proud to testify today on behalf of the 1 million REALTORS®, the 75 million Americans who own homes, and the 310 million Americans who require shelter. Thank you for the opportunity to present our views on the importance of FHA.

There is a common misconception that exists that FHA was intended only to benefit low-income borrowers who could not afford large downpayments on a new home. The truth is that FHA was intended to provide safe, affordable mortgage financing to all Americans in all markets, high- and low-cost. To that end, FHA has been a critical part of the Nation's economic recovery, especially in the last few years when the private lenders have left. The program has outperformed all expectations in providing safe, affordable mortgage financing to home buyers in all markets during these economic conditions.

The fact that FHA has successfully operated for 77 years as a self-sufficient entity, without expense to American taxpayers, speaks to the value of the program and its management.

During the past year, the FHA has taken a number of steps to mitigate risks that have resulted in greater improvements in the loan performance package in the MMIF. These include increasing mortgage insurance premiums, raising downpayments on riskier borrowers, and increasing lender enforcement. So while there has been much made of the fact that the FHA audit showed capital reserves falling below 2 percent, the fact is that FHA loans are outperforming the private market. Loans originated in Fiscal Year 2010 are the highest-quality FHA book of business has ever had.

The current average credit score for FHA borrowers is up to 703. FHA's seriously delinquent rate continues to decline, and the FHA foreclosure rate is lower than the rate for prime conventional loans. In fact, FHA's recent audit shows that if FHA makes no changes in the way that they do business today, the reserves will go back above the 2 percent threshold in the next several years.

What we need now, what we really need now is for markets to heal, to self-correct, and to stabilize. The more you manipulate the markets, the more you magnify the problems.

Specifically, we strongly oppose the proposal to further increase FHA downpayments. Increasing FHA downpayments would not add a penny to FHA reserves. The housing prices demonstrated that the key to reducing foreclosures and defaults is underwriting, not downpayments. And this is evidenced by the fact that FHA loans and VA loans have lower foreclosure ratios than prime conventional mortgages.

We also strongly oppose provisions to decrease loan limits. Instead, we urge support for H.R. 1754, the bill introduced by Representatives Miller and Sherman, to make the current limits for FHA and GSEs permanent.

Decreasing the loan limits would impact 3,049 counties in every State in the Nation and reduce the availability of mortgage loans for millions of home buyers. The decline would have a dramatic impact on the housing recovery and, we think, would halt it. In my own market area, the change would go from 475 to 241, almost in half.

That said, we strongly support the provisions of the discussion draft that provide FHA with increased tools for oversight and enforcement. We believe that FHA has shown tremendous strength in the current crisis. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry.

To be clear: one, we oppose any increase to the downpayment; and two, we oppose any reduction in the loan limits. What our economy needs is less government interference and more market activity. Thank you.

[The prepared statement of Mr. Phipps can be found on page 128 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Phipps. Mr. Rutenberg, you are recognized for 5 minutes.

STATEMENT OF BARRY RUTENBERG, FIRST VICE CHAIRMAN, NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. RUTENBERG. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to testify. My name is Barry Rutenberg, and I am a home builder from Gainesville, Florida, as well as first vice chairman of the board for the National Association of Home Builders. NAHB represents over 160,000 members, many of whom rely on HUD programs and FHA to help provide decent, safe, and affordable housing to many of our fellow citizens. We commend the subcommittee for working to reform FHA, Ginnie Mae, and Rural Housing, yet we urge reform to be approached with caution.

Changes to these programs cannot be separated from reform of the complex housing finance system, including future reforms to Fannie Mae and Freddie Mac. The Federal Government, through FHA and Fannie and Freddie, currently accounts for nearly all the credit volume to home buyers and rental properties. Even with this, fewer mortgage products are being offered and loans are underwritten on much more stringent terms adversely affecting home builders and buyers alike. As changes to the housing finance system are discussed, NAHB believes that it is crucial that there be a permanent Federal backstop to ensure a reliable and adequate flow of affordable housing credit. NAHB has been very supportive of FHA's changes to ensure that the mutual mortgage insurance fund is sustainable.

We understand FHA has a disproportionate share of the mortgage market, and current levels are neither desirable nor sustainable. The subcommittee has proposed changes, including: increasing the downpayment to 5 percent; prohibition on financing certain closing costs; potentially higher mortgage insurance premiums; and lowering mortgage limits.

NAHB believes these changes will restrict access to FHA credit and we have strong concerns about the impact of the proposed reforms on FHA's ability to maintain its critical mission of supporting home buyers during a tenuous juncture in the economy. NAHB believes that increasing the downpayment from 3.5 percent to 5 percent will create a substantial burden for home buyers, especially younger buyers and those with strong credit profiles but not enough available funds to make the increased downpayment.

Not often considered is the impact on homeowners looking to move up who cannot do so because of the reduced number of qualified buyers. NAHB appreciates the continued focus on strengthening the FHA's risk management practices. However, we are concerned that removing the ceiling on the annual MIP presently at 1.5 percent to result in a higher annual MIP. Increasing insurance premiums puts additional financial strains on home buyers who potentially could be buying excess housing inventory. NAHB has concerns for the proposal which would calculate the FHA loan limit based on 125 percent of median home price by county with no floor and a ceiling equal to that established in 2008 under HERA.

Eliminating the floor for FHA loans would reduce the loan limits for significant parts of the country, including large numbers of first-time buyers without a key source of mortgage financing. In my hometown in Alachua County, Florida, we would go from $270,000 to $190,000, a drop of 30 percent.

NAHB supports making permanent the current loan limits for FHA and GSEs and strongly supports H.R. 1754, the Preserving Equal Access to Mortgage Finance Programs Act, introduced by Representatives Gary Miller and Brad Sherman.

Turning to multi-family, there are a few alternative sources of financing for multi-family rental housing. FHA, Fannie Mae, and Freddie Mac have provided the vast majority of financing for multi-family rental housing during this economic crisis and will continue to do so for the foreseeable future. The discussion bill proposes to establish capital ratios for the GI/SRI funds.

While NAHB applauds the strengthening of FHA's risk management practices, we strongly urge the subcommittee to conduct an in-depth study to determine the appropriate levels and timeframe in which to implement them. With regards to rural housing, we are also opposed to the proposed transfer of the rural housing programs at HUD. NAHB believes that the rural housing programs are uniquely structured to address low- and moderate-income persons in rural areas. NAHB fears that it will be more difficult for persons living in rural areas to obtain an affordable mortgage and considerably more difficult to finance small properties in rural areas. We appreciate the key role FHA has played in keeping our housing market liquid, stable, and affordable. Looking at ways to improve the housing market is not an easy task. NAHB has some serious concerns on how to move forward, but we would like to continue working with you as you progress. Thank you for your time and this opportunity to testify.

[The prepared statement of Mr. Rutenberg can be found on page 148 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Rutenberg.

We will now turn to questions from members. And I will recognize members for 5 minutes each to ask their questions, and we will try to keep to that. I will yield myself 5 minutes for questions.

Mr. Phipps, in a FOX News article that was published yesterday, it says that, "The National Association of REALTORS®," citing Obama Administration estimates from last year, said that, "if the required payment rose to 5 percent, more than 300,000 creditworthy buyers would be locked out." Do you know how that figure was determined?

Mr. PHIPPS. I believe actually that is from the FHA, and I can verify that and provide that in a written statement. Madam Chairwoman, one other thing that I think needs to be brought to the conversation is when you are a buyer, you have to come up with more than 3.5 percent. And I think what has been lost in the conversation is that there is an insurance premium with FHA and there are other closing costs. So that, in terms of the hard money the buyer has to come up with, often it is from 7 percent to 10 percent, even though the downpayment is only 3.5 percent. So I want to make sure that piece is introduced. We will provide the documentation as to the source of the 300,000.

Chairwoman BIGGERT. The problem with the 300,000 was, how was it determined? I know that it was the Administration, but I wondered if they explained to you how they reached that number?

Mr. PHIPPS. Go ahead, Brian.

Mr. CHAPPELLE. It was in testimony last March, FHA Commissioner Dave Stevens had it in testimony last March that talked about the 40 percent decline in borrowers and 300,000.

Chairwoman BIGGERT. I do have the testimony. Thank you. I just wondered if any of you had asked him how that was determined? Mr. Calabria?

Mr. CALABRIA. I haven't asked him. But if you look at the overall distribution of FHA's business in 2009, then his assumption must be that everybody who paid in that range simply cannot. So his assumption is based on that, you would never have any more money to put in as a downpayment. So Commissioner Stevens' assumption is simply that everything above 95 percent goes away, which I think is a pretty strong assumption.

Chairwoman BIGGERT. Okay. Thank you. I guess then that there was no definite on that. It was assumptions.

This year, the same Administration has proposed a QRM rule that would require borrowers to have a 20 percent downpayment. Can anyone comment on the discrepancies between the Administration's opposition to a 5 percent downpayment last year and his proposal for a 20 percent downpayment this year? Does anybody have any comments on that? Mr. Berman?

Mr. BERMAN. Chairwoman Biggert, it would appear that the right hand and the left hand aren't taking a holistic view of the impact on the market. Clearly a 20 percent downpayment, as suggested in the current QRM, would have a dramatic impact on bringing private capital back into the sector, which is something that clearly the Obama Administration and I think all of us feel is necessary. So we would hope that the entire QRM proposal would be reconsidered.

Chairwoman BIGGERT. Okay. Then instead of increasing the downpayment for FHA, let's look at the alternatives. Decreasing the downpayment. Would a zero downpayment stoke the housing market? Would that get it going more? And if Congress approved such a change and FHA implemented that change, what would happen to the FHA fund? Would taxpayers be at greater risk and need to bail out FHA? Would anybody care to comment on that? Let's try Mr. Petrou.

Mr. PETROU. I think that what is important to think is not just the downpayment isolated, but also interconnected with the amount of insurance coverage on the loan. So that, for example, the VA program has a zero downpayment, but they only cover, at most, 50 percent insurance coverage on the loan and the insurance coverage falls as the loan amount goes up. And so most VA loans are looking at 25 percent insurance coverage. When you have a restructured system that looks at all of the factors in underwriting, you can, in fact, make a zero downpayment program and have the underwriter basically look at the loan from the perspective of what his own risk is going to be. And that, I think, is the key. Just picking one little part out and saying, let's change this and not look at everything else ends up with a problem.

Chairwoman BIGGERT. Okay. Mr. Calabria, I think you had, in your testimony, talked about the loan performance in correlation with the downpayment.

Mr. CALABRIA. That is absolutely a very important part. Let me say, for starters, and go back to the QRM. I think the QRM is probably beyond repair and Congress should seriously consider just repealing it outright. It is probably beyond fixing, in my opinion. An important thing to keep in mind about a downpayment is it is one of many factors. And if you change the other factors, what concerns me when I suggest we need to raise the downpayment is I hear zero discussion of changing the other factors, such as credit score. If you give people with a very bad credit a very low downpayment loan, you will see a high default.

If we want to move FHA towards setting higher minimum credit scores, then you wouldn't have to worry about the downpayment. So again, it is the pieces moving together. And if you are not mentioning the other pieces, you need to focus on the downpayment. If you are going to change the other pieces, then you don't have to change the downpayment.

Chairwoman BIGGERT. Thank you. My time has expired. It goes very fast. The gentlelady from California, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman. I have identified some of my concerns when you gave me the opportunity to have an opening statement. And I would like to follow up on some of that. First, let me ask Mr. Calabria, I see that you have a tremendous background in public policy. You have worked here on the Hill. You have worked at HUD. You have done research. Have you ever been involved directly, like boots on the ground, with real estate sales or anything like that?

Mr. CALABRIA. I will start with—

Ms. WATERS. No, no, no, no. You don't have to go back to all that. We have read it already.

Mr. CALABRIA. I was going to start with my own experiences buying a home and also in addition to the policy experience that is listed there, I spent a tremendous amount of time with constituents, as I know many of us have in trying to make—

Ms. WATERS. I am going to cut you off because I don't want to take up my time with the history. We all buy homes. I am looking for real hands-on experience. Let me go to the REALTORS®. Mr. Phipps, are you heading an association because you have some experience or background in public policy or doing—as an analyst or a consultant? Or have you been on the ground talking to people and writing loans and mortgages?

Mr. PHIPPS. Yes. Yesterday morning, I was showing clients houses.

Ms. WATERS. Okay. Then you are the one I want to talk to. Can you react to the claim in Mr. Petrou's testimony that increasing downpayment requirements will not adversely affect first-time or low- and moderate-income home buyers? I want to get a better understanding of this downpayment debate.

Mr. PHIPPS. Our experience would suggest that is just simply not true. In my own personal experience, I work with a significant number of buyers who do not have 20 percent down. Most recently, the couple that I was working with yesterday did not have 20 percent down. They will have enough for 5 to 7 percent. They are looked at and preapproved on a very comprehensive basis. And one of the things that we have learned from the experience of 5 years ago is how to look at holistic approvals. We think it is too rigorous now. But if you increase the amount down, you really take a lot of people who should be able to buy who will be responsible, sustainable homeowners out of the marketplace. And that amplifies the problem for value. You are not absorbing the inventory then.

Ms. WATERS. So would you be referring to, for example, a young couple, both working, renting property, pay their bills on time and are saving some portion of their income—as much as they possibly can with average salaries—who want to get into a home and perhaps can get, like you said, 3 to 5 percent down. But 20 percent, 10 percent would be a real reach for them.

Mr. PHIPPS. It is real. It really is real. Last year, I worked with a couple. He was a Narragansett police officer, and she was a schoolteacher. If they needed more than 3.5 percent down, they would not have been able to buy the home. And they bought in Apponaug, they bought in Warwick. That is real.

Ms. WATERS. These are not deadbeats, are they?

Mr. PHIPPS. No. A police officer and a schoolteacher. When we come here, what is very frustrating is there is a lack of appreciation—we are talking individual families. And the families really, their skin in the game truly is ownership. They know that long term, it is important for them to be homeowners. But if it takes the average family 14 years to come up with 20 percent, you postpone their ability to own for a long time. Plus, it doesn't make a lot of sense. And we think the facts—and we can provide you with lots of documents—but please remember that each statistic is a family, a family who wants to own and understands the value of homeownership.

Ms. WATERS. These are people that you see in your business and the REALTORS® interact with and they know who we are talking about and what we are trying to do and the average American that we are trying to assist in the American Dream, is that right?

Mr. PHIPPS. Yes, ma'am. In all 50 States, in every town and city in this country.

Ms. WATERS. I yield back the balance of my time.

Chairwoman BIGGERT. Thank you, Ms. Waters. Mr. Hurt, you are recognized for 5 minutes.

Mr. HURT. Thank you. And I thank each of you for your testimony this morning on a very important subject. I guess I kind of come at this subject with a couple of things in mind. Number one is, obviously, we want to I think in this country encourage responsible homeownership everywhere wherever we can. But I think also we have to remember that these programs and with the backstop offered by the government, these things propose a risk to the taxpayer. And I think that we see examples of that, that we are not dealing with in other bills. I also think philosophically that, to the extent that the free market can address the issues and address these issues on its own without government intervention, I think that that is what we should work toward.

So I was interested to hear Mr. Phipps talking about wanting more market activity, which I think we would all agree with. We want to see more market activity. But also talking about less government intrusion. I guess for my part philosophically, I think that a government backstop encourages behavior that perhaps could not be sustained if the system was totally within the private sector. And I guess my question—I would love to hear from Mr. Phipps and Mr. Rutenberg whether or not you believe it is legitimate to want to have the private sector come more into the mortgage market or not because it seems to me that by increasing the downpayments very modestly and by reducing the loan limits modestly, while it may have an immediate effect in the long term, it would encourage the private sector to come in.

So I would like to just hear you say—do you think that the private sector should come into this market more and FHA has too much? Or do you think we should just leave it the way it is? And if we do take these actions, increasing the downpayment—this is the second part of the question—if we do take these actions, will the private sector come in? And if maybe Mr. Phipps and Mr. Rutenberg can address that individually. Thank you.

Mr. PHIPPS. The short answer is, we would like to see more private activity in general. We think the reliance on FHA is probably unnecessarily large. But they are filling a void that the private sector has not stepped into. As a practical matter, when you talk to the GSEs and you look at the fact that their credit scores have gone from 720 now to 760, there is a good portion of the market that should be able to have access to the market that do not. That is a major problem.

Our fear, our genuine fear is that when you look at the limited amount of private activity in the marketplace right now that there is no entity to step in and fill that. And this industry relies on the flow of capital. So for the immediate present, we need what we have in place and more so that transactions can happen. But we don't see anybody else ready to step into the market and fill the void that we need across-the-board.

Mr. HURT. But if you support the idea that the private sector should come in, then let me ask you this: How would you do it? We have to make that decision. I know you are not sitting up here. We are sitting up here. But how do you do that if you support that philosophically?

Mr. PHIPPS. The short answer is, and your comment about interference, we would like the system that FHA has in place right now to stay in place. The improvements for enforcements, etc., are fine. On the GSE piece, ultimately we believe we need a government guarantee. At the end of the day, we believe that is what we need and we need that. And then you can have more flow and reliable floor. We really believe, at the end of the day, you will need a government guarantee.

Mr. HURT. Thank you. Mr. Rutenberg, if you don't mind?

Mr. RUTENBERG. I am a home builder. I talk with clients. I haven't talked to one since about 9:40 this morning. The market is healing. It is taking a while. It has taken longer than we would want. I think that when we talk about one thing at a time, what we miss is how interactive all the pieces are to our buyers. When we sell a house, we no longer tell them they are going to have a mortgage application. We now tell them they are going to have a mortgage inquisition. The amount of data, the amount of the depth that has been gone into is setting a base for a much healthier future. You can look at the numbers that many people on this panel have talked about, how things are improving.

It has not improved enough yet to where a lot of private money is coming in. The major lenders are still straightening out some of the things that have happened in the past. They have not yet quite seen their profit potential. But as the market comes back, they will come back and they will participate more. It won't be exactly as you probably would want it without you having to motivate them.

There is so much potential that is out there that they will come back. But they have lost so much money over time that their eagerness is not there yet. And they will put their toe in and they will gradually come back. We don't think that we should have Fannie and Freddie and the FHA at the current levels. But at the moment, if you did not keep them here where they are, we would see further problems in financing. You would see further declines in the house prices that would further erode consumer confidence. You can play the economics out of in your head.

Chairwoman BIGGERT. The gentleman's time has expired. The gentleman from California is recognized for 5 minutes.

Mr. SHERMAN. Thank you. To hear the philosophical comments from the Cato Institute, from the gentleman from Illinois, I would remind you that whatever the philosophy is for some perfect world or where we might want to be 20 years from now, right now, the patient has suffered a heart attack and is on the gurney. And even if you believe fervently in exercise, usually a triathlon should take place more than a few weeks after the heart attack. This bill gives us a chance to experience a double-dip recession. The best way to have a double-dip recession is to see another dip in housing prices.

I particularly would like to focus attention on those areas where you have high-cost housing. And this bill would take the FHA from $729,000 down to $537,000 in Los Angeles County. Mr. Phipps, what effect would that have on home prices, not only of the homes that sell for $800,000. But if they drop by a couple hundred thousand dollars, what is going to happen to the home that traditionally sells for a couple hundred thousand dollars less than that?

Mr. PHIPPS. The short answer, Congressman, is the entire market is linked. So as the upper bracket gets pressure on prices, downward pressure because financing becomes harder, it has a ripple effect in both directions. So the bottom line is you are going to see a huge loss of equity. And candidly, what is frustrating about the proposal is it is done by county rather than metropolitan area. So it de facto becomes a redlining. You are going to have certain counties that are much more negatively impacted because you are not allowing for the whole presence of the metropolitan area. So it has a huge negative impact on value.

Mr. SHERMAN. And it is that county rather than the metropolitan area that would be responsible for the drop to about $537,000 in L.A. County, really a $200,000 drop. A recent report showed that three banks are closing half the mortgages. And now this bill would cause an awful lot more mortgages to have to be held in part or in full by—in the portfolios of banks rather than sold as securities. That means the banks that would benefit with those would be the lowest cost to funds and those are the banks that are too-big-to-fail and enjoy an implicit Federal guarantee.

What impact does it have on the market to have 3 banks controlling 56 percent of the market? And what impact would it have for those loans over, say, $537,000 where you might see 70 or 80 percent in the control of these 3 banks?

Mr. PHIPPS. There is less competition. So that, in fact, the cost of the money would be more expensive. You will have fewer options. When I started in the business 30 years ago, the top 5 lenders represented less than 25 percent of the market. We have such a concentration now that it is unlikely—you can't shop the mortgage the way you used to. And the underwriting criteria universally is the same. So there are real constraints as to what you would have available.

Mr. SHERMAN. I would also point out, you understand the pain from the home buyers' perspective. In this room, the greatest pain was when we had to consider the TARP bill. Some voted one way, some voted the other. But if these institutions are able to add to their portfolios 56 percent—huge percentages of mortgages in addition to their other assets, they become really, really too-big-to-fail. And so you may see pain here as well as with your customers. And they also become concentrated in real estate. If you want to respond?

Mr. PHIPPS. Congressman, if I may make one other point. One of the challenges right now, if you are self-employed, if you are a 1099 person, your ability to get financing is extremely difficult because the large lenders really prefer people with W–2s. So there is a huge piece of the market that is having trouble being placed. It would actually be in the market right now. And that is indicative of the lack of flexibility and competition.

Mr. SHERMAN. As an old tax collector, I would say I would only want those with the 1099 income, reporting all that income. And I am sure that is the kind of person you had in mind.

Including a recently announced increase, FHA increased premiums 3 times last year. How does this affect home buyers?

Mr. PHIPPS. It has actually reduced the number of people who are able to finance and the people who are being approved now are much more creditworthy. It just seems to me, we are trying to fix a problem again that we have already addressed. If we let the market absorb the changes that are in place now, that is better for us.

Mr. SHERMAN. Thank you.

Chairwoman BIGGERT. The gentleman's time has expired. The gentlelady from West Virginia, Mrs. Capito, is recognized for 5 minutes.

Mrs. CAPITO. Thank you, Madam Chairwoman. I thank all of you. I want to talk about two things, I hope I have time for them. First of all, I want to talk about USDA Rural Housing Service proposal to move it within HUD. The folks—I believe it was Ms. Alitz and Mr. Carey talked a lot about this. We are looking for efficiencies in government obviously and we have the $14 trillion debt that we all know about. There was a report that came out maybe a month or 6 weeks ago—and I can't remember exactly what is the title of it—but it talked about duplicative housing programs across all the different government agencies. And certainly, I represent a very rural area. You know when I hear loan limits of—our housing price is probably $120,000. So it just boggles my mind that $700,000 to move down to $500,000 is going to be so painful because in my area, that is somebody living on the hill, big.

So I want to know, you have both said that you think this is not a good idea because you think it would dilute the ability to reach the population that this program is designed for, which are the very low-income rural areas. Do you think if the expertise was transferred from USDA into—I am talking about staffing and infrastructure—into HUD within the umbrella there, I am looking for efficiencies here. Do you still think that if it was not done precisely and carefully that HUD couldn't retool into this market and be just as effective as the USDA has been?

Ms. ALITZ. We actually said that we think there are pros and cons to the plan. We just don't know enough about it right now. And we have to, I think, take a stronger look at it. That is one of the cons. We think if the whole thing was transferred to HUD, it would be shoved in a back room somewhere and it wouldn't get the attention that it deserves. And currently, what I hear from most of my membership is those that deal with rural development on a daily basis, they have a pretty good line of communications and they have good relationships and they are afraid of losing those. But we do think that there are some pros to looking at moving to HUD. And those are mostly related to funding. We have had problems with the current Administration's budget and we wonder about the USDA's commitment to its rural housing portfolio.

Mrs. CAPITO. Right. We had the issue in April where we had to keep moving.

Ms. ALITZ. Right. So we think that their funding sources—this portfolio really needs to be conserved because it is aging. Most of it is over 20 years old. We think for funding purposes we may be better off at HUD.

Mrs. CAPITO. Mr. Carey?

Mr. CAREY. I think the important element of the USDA delivery system is the infrastructure that is in rural communities. They have a presence. They are community members. Sort of like community bankers, like we used to have. So they are there. And their delivery system typically collocates and combines farm service programs, soil conservation, wastewater and water assistance, community facilities funding and homeownership and rental housing.

And my first experience was in Buffalo Creek rural housing. When a borrower for USDA loan wants to apply for a loan, they go to the local office and they are dealing with local people. And if you take the housing out of that system, you will still have that same system there but nothing to replace it from HUD because HUD—if a homeowner in a local community in Farmersville, California, wants to borrow from HUD, if HUD was direct lending, they would go to San Francisco, not the same as going to somewhere 10 miles away.

Mrs. CAPITO. The other way—and I only have a minute left—is on the QRM. I have heard from several folks who think it needs to be thrown out, retooled. It is going to be ineffective. It seems to me what I am hearing baseline—and correct me if I am wrong—is that this creation of the QRM is just going to bloat FHA even more. I see a lot of nodding heads. Does somebody want to comment on that? I will go with Mr. Berman and then Mr. Rutenberg.

Mr. BERMAN. Sure. So if the concept is that we are trying to bring private capital back into the market—and I think we all agree on that—and yet we are going to put these significant constraints on private capital, we are going to have—

Mrs. CAPITO. Have adverse effects.

Mr. BERMAN. Exactly. An adverse effect.

Mrs. CAPITO. Mr. Rutenberg?

Mr. RUTENBERG. The QRMs are probably flawed. Hopefully, they will not go in as they are. But if it does go in, it will put a lot more pressure on FHA to do more lending, no question.

Mrs. CAPITO. Thank you.

Chairwoman BIGGERT. The gentlelady's time has expired. The gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you. Madam Chairwoman, I don't know where to start. I just have a couple of questions. Mr. Phipps, did I hear you say you are from Rhode Island?

Mr. PHIPPS. Yes, Congressman.

Mr. CAPUANO. Have you done any work in the greater Boston area?

Mr. PHIPPS. I am licensed in Massachusetts and Vermont.

Mr. CAPUANO. Great. I represent, Boston, Somerville, Cambridge, and Chelsea. Do you know any place in my district where I can get a reasonable house for less than $500,000?

Mr. PHIPPS. The short answer is, it is challenging.

Mr. CAPUANO. It is challenging?

Mr. PHIPPS. With a good REALTOR®, yes, I think that you can. But $500,000 is—

Mr. CAPUANO. A really good REALTOR®. The reason I am amazed is when you say increasing a downpayment from 3.5 to 5 percent, that doesn't sound like much. That sounds reasonable. But when you put it down on a $500,000 home, that is $7,500 in cash. Which I know that there is probably nobody here at this table who has a problem coming up with $7,500 in cash, but a lot of my constituents do. And that means that they will never own a home. Has anybody had any discussions yet about maybe a sliding scale? I understand that more people can afford certain things. That is fair. Have there been any proposals for a sliding scale downpayment?

Mr. PHIPPS. Not that I know of.

Mr. CAPUANO. Does anyone else know of any proposals?

Mr. CHAPPELLE. FHA used to have a sliding scale historically.

Mr. CAPUANO. Yes, I know.

Mr. CHAPPELLE. They switched in 1998, I think, to make it simpler so people could understand what the downpayment was so it would be a flat percentage of all loan amounts.

Mr. CAPUANO. You do realize that most people who go in to get an affordable mortgage don't understand much. They just want to get a mortgage. And if you tell them what they are going to put down, they are going to say, yes, I can afford it, or no, I can't.

Mr. CHAPPELLE. The only thing I would add, Congressman, is that the performance of the FHA Fund today demonstrates that low downpayment loans perform very well. So I don't think there is a need from a statistical performance perspective.

Mr. CAPUANO. I am fine with having no need. I am painfully trying to be reasonable which is tough for me, but I am trying.

Mr. CALABRIA. If I could comment, FHA actually does have a little bit of a sliding scale now in that if you are below a certain credit score they require you to do the 10 percent. So there is a sliding scale in mind. And I think if you are going to base it that way, again, we know it is the interaction between the credit score—as Ms. Waters said, people paying their bills on time versus downpayment. So you could do a sliding scale on credit and FHA has actually proposed—

Mr. CAPUANO. Bringing up FICO scores is a whole different issue which is another little bit of a problem. Conceptually, I don't disagree. But we have to get FICO scores right first.

I guess the other question—I want to just thank the Majority staffer who wrote the little memo for today because they made my point. Prior to the creation of the FHA, home mortgages did not exceed 50 percent of the home value and did not extend past the 5th year. The rates were about the same rates as we have today, give or take 5 or 7 percent. But 5 or 7 percent over 5 years versus 30 years, does anybody have any clue how much that is? Because I do. I think the official answer is, way too much money for anybody to afford which is why people didn't have homes.

I guess I am sitting here today—there is no argument that—look, the private market has a role to play in this. But somebody needs to tell me why right now we are having a hard time getting people into homeownership when the home builders are building nothing, for all intents and purposes, because there are no buyers out there. We can't move this part of the market around. Why in the world would we want to, overnight, simply just shut down one of the few escape valves we have had, other than for some holy sacred cow that we want to light candles at?

Mr. CALABRIA. Since I sort of feel this coming my way, I guess I will—

Mr. CAPUANO. It is not personal.

Mr. CALABRIA. Exactly. I don't take it that way. First of all, I think certainly myself—I know that it has been clear—that any sort of transition should be over time. For instance, I don't propose getting rid of Freddie or Fannie tomorrow. I think it needs a 5- or 6-year period. I see these changes that have been proposed in FHA as quite modest.

Mr. CAPUANO. So you want to do them all together?

Mr. CALABRIA. Absolutely.

Mr. CAPUANO. That is fine. You just made my point. So you think it is okay to go back to—or you think somehow the miraculous market that didn't exist before Fannie and Freddie will somehow exist now. The goodness and the graciousness of the private market will get rid of those 5-year mortgages.

Mr. CALABRIA. I think if you go back and you actually look at the data on homeownership rates—I would be happy to come in and show you some time—

Mr. CAPUANO. Oh, please do.

Mr. CALABRIA. —in the 1950s and 1960s, when Freddie and Fannie's market share was essentially zero, homeownership—look at the data.

Mr. CAPUANO. I have looked at the data. Take a look at the homeownership rates prior to the 1930s.

Mr. CALABRIA. The homeownership rates prior to the 1930s was about 45 percent. Homeownership was not limited to the wealthy prior to the New Deal.

Mr. CAPUANO. And you think that is a good idea?

Mr. CALABRIA. I think that you would have it any other way. You have had income growth. You had a lot of other reasons—

Mr. CAPUANO. It is okay to think it is a good idea. I just seriously disagree with you.

Mr. CALABRIA. First of all, I think it is absolutely the wrong idea to target the homeownership rate as a matter of policy. I think that is one of the reasons we are in the mess we are today. I think homeownership rates would be upper 50s, low 60s if we had no Federal support. And I am absolutely convinced of that and I think there is significant data to support that. So it is not simply some sort of philosophical choice.

Mr. CAPUANO. See, here is where we have a basic philosophical difference. When my ancestors came over, they didn't come over with a satchel full of cash.

Mr. CALABRIA. Neither did mine. Mine came from nothing.

Mr. CAPUANO. I appreciate that. And guess what got them into the middle class, homeownership.

Mr. CALABRIA. You know what got mine into the middle class? Working.

Mr. CAPUANO. Oh, that is good for you. Because my family never worked. We were on the dole. That is very good.

Chairwoman BIGGERT. The gentleman's time has expired, fortunately.

Mr. CAPUANO. Does anybody want to yield?

Chairwoman BIGGERT. And I would say to the gentleman that you missed the beginning of this.

Mr. CAPUANO. Oh, no. I watched it on TV.

Chairwoman BIGGERT. We have several drafts that we are looking at, and to have this kind of dialogue so that we can really do no harm.

Ms. WATERS. Madam Chairwoman, since we have so few members on this other side, can I make a unanimous consent request to give the gentleman 1 more minute?

Chairwoman BIGGERT. Must I? The gentleman is recognized for 1 more minute.

Mr. CAPUANO. Thank you, Madam Chairwoman.

Mr. GARRETT. If the panel gets another 30 seconds to respond.

Mr. CAPUANO. I would love this.

It is amazing to me that your family was the only one who worked in all of America, that none of us did. See, the difference between people who think that homeownership should be left to the private market and people like me who think the government has a role to play to ensure that the middle class can afford homes because nobody else has ever done it in the history of the world except when government got involved, that is the only time it has ever happened. The reason I think that is because people like me would never have gotten into the middle class. We would still be driving trucks for vegetable farms that don't exist anymore. And I know that is fine. That would have served your purposes just fine. But most of my constituents would never have owned a home. And I personally think that is what has made America great. That is how my kids went to college, remortgaging the house.

Now I know that many people in the financial services world don't have to do that. Many people, most people do. And that is why I came today. I am not opposed to trying to narrow some of these things down. Nobody wants bad mortgages given out to bad people or people who can't afford it. That is ridiculous. It kills the whole system. But to sit here and pretend or argue—

Chairwoman BIGGERT. The gentleman's time has expired.

Mr. CALABRIA. The panel's time perhaps?

Mr. GARRETT. I seek unanimous consent to give 30 seconds to Mr. Calabria to respond.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. CALABRIA. I very much appreciate the point. I think if you go back, and again, you look at the historical data when people actually had equity in their homes—for instance, in 1980, the typical equity in a home was 70 percent. So the question is whether debt creates homeownership. If we want to subsidize homeownership, why don't we subsidize home equity rather than home debt? Getting people leveraged over their head is, in my opinion, not a way to create the middle class. And again, the middle class has to pay taxes too.

There is another side of this. Do you want to know what my experience is? My experience as a taxpayer is, and I think a lot of people out there, the more you pay in taxes, the less you actually have to spend towards your mortgage, toward the other necessities of life. So all of these pieces fit together. And I think it is important ultimately to ask at the end of the day, do we get much for the money that we spend in our mortgage finance system? I think the answer is absolutely not. I think the bill in front of us contains very minor changes that do not gut the system to any extent of the imagination.

Chairwoman BIGGERT. Thank you. The gentleman's time has expired. The gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. Let's just try this from another tact.

So is there anybody on the panel who does not believe that there is risk in the marketplace today? No. Does anybody believe that we should be pricing for that risk in the marketplace today? We all agree that we should be pricing for that risk. Does anybody disagree that we, as far as the accounting methodology that the FHA uses, that accounting should be transparent and show that pricing risk as well? Does anybody disagree with that? You disagree with that. We should not show that. Yes?

Mr. CHAPPELLE. Are you referring to the CBO study on fair value accounting?

Mr. GARRETT. Sure.

Mr. CHAPPELLE. The only trouble with fair value accounting, as I see it, Congressman, is that the value is an estimate. It is a projection. And the projection that the CBO used was based on Fannie and Freddie's fees and the private mortgage insurance fees. So you are comparing government, which is hard to compare because you can't find something comparable.

Mr. GARRETT. So what fees are used right now? Only FHA. GSEs doesn't do this, right? The FHA uses the valuation of what, treasuries as basically accounting.

Mr. CHAPPELLE. Right.

Mr. GARRETT. Does anyone on the panel believe that the current pricing of treasuries is what we are going to see 3 years from now, 10 years or 15 years? Or are we going to stay at these historically low levels? So everyone agrees that the treasuries are going to go up. Does anyone believe that they might go up significantly? A lot of nodding heads. So is it fair, then, that we are using that as the basis for the valuation?

No. Okay. So if that is not the correct valuation for valuing, then perhaps the CBO score is. So do you use fair value? Or some variation of a fair value accounting.

Mr. CHAPPELLE. If I could answer, Congressman. The concern I have with the fair value is it is based off of Fannie, Freddie, and MI fees. The MI fees are comparable to FHA fees. If the Fannie and Freddie fees were not so high, the private mortgage insurance business would be back in business today. But because of those fees that Fannie and Freddie charge, which they are set because they are trying to—I understand why they set them where they set them—but they are trying to preserve capital for the taxpayer which is an altruistic reason. But the upshot is, it is making the private sector less competitive. The point is, FHA has raised its fees 4 times in the last 3 years. They have raised them 60 percent. They have gone up to the highest fees in FHA's history.

Mr. GARRETT. So what you are saying is that the CBO score evaluation is wrong?

Mr. CHAPPELLE. No, it is not wrong. Excuse me, Congressman. It is not wrong. It is just that by using Fannie/Freddie data, FHA is doing fine. I wouldn't say FHA is charging too little. I would say Freddie and Fannie are charging too much.

Mr. GARRETT. It looked like you had a comment.

Mr. CALABRIA. I will make a couple of quick points. Along fair value, absolutely when you were transferring risk from the private sector to the government, there is market risk involved. This is not charged. So if the government is giving something to the private sector, that should be priced appropriately. We did that in the TARP. And I think it makes sense in this context. And I want to reiterate a point I made in my written testimony. FHA does not charge to cover its administrative expenses. I don't know what business, if it didn't pay its employees, would actually claim to be profitable.

Mr. GARRETT. So we are in agreement that we need more transparency. We are in agreement on the panel that the current methodology, which is using Treasury rates for discounting, is showing at—because of the law as having no cost to the government for the risk-based in there. And it seemed to be correct. So we should be on agreement then on this panel, then, that we need to move away for proper accounting methodology from what we are currently using to something else. Perhaps not to the CBO score methodology for that reason, but to some—although I don't know what else we should be going by here in this committee and on the Budget Committee because that is what we go by in this House. And if the panel's recommendation is we go askew from that, but we should move away from what we have right now to include risk assessment. Do I see any objection? I don't. I only have 55 seconds left. Let me just change a topic there. Default rates. Quickly, can someone just tell me what the current default rate is now at FHA?

Mr. CHAPPELLE. The total default rate, their 90-day delinquency is about 8.7 percent. That is the total portfolio.

Mr. GARRETT. So it is around 9 percent. Okay. Do we have a target where we want to be on our default rate, FHA?

Mr. CHAPPELLE. It is a balancing act, Congressman, between the premiums charged and the number of defaults and claims.

Mr. GARRETT. That is a good question. Do premiums currently adequately cover the default rate?

Mr. CHAPPELLE. Yes. Because that is what the actuarial review determines.

Mr. GARRETT. Wait, how can you say that when just a minute ago, you all agreed that the current valuation was not correct because it is based on treasuries, not assuming any market rate. And that is how you came up with around a $4.4 billion savings. You would actually have a $3.2 billion cost under the CBO score. So you really can't say that the premiums are—

Mr. CHAPPELLE. Congressman, the determination that its shortfall is $3 billion is predicated on the fact of the fees Fannie, Freddie, and the MIs are charging.

Mr. GARRETT. But you all already agreed that the current methodology is not adequate, so we need to go away from the current methodology based upon the Treasury rates, basically no discount rate involved there. So if you all agreed on that, then you really can't say that the premiums are currently are based correctly because you—

Mr. CHAPPELLE. Congressman, I am no expert on accounting.

Chairwoman BIGGERT. The gentleman's time has expired. I can't get a word in edgewise, you talk so fast.

The gentleman from Ohio, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman. The first question I want to ask the panel is just about the current status of the multi-family market. Can anybody give me kind of an update of the role of private capital in the multi-family market today and how much private capital is engaged in the multi-family market today and how this asset class have performed through the crisis? Mr. Berman?

Mr. BERMAN. Congressman, the multi-family market is one of the few areas where liquidity has started to return. Having said that, last year, between Fannie, Freddie, and FHA, it still represented at over 80 percent, close to 90 percent market share. We have seen private capital come back into the sector over the last 6 months. But it is really a tale of two worlds. Most of that capital has come in at the luxury end of the market, and then what I call the gateway cities. If you go to secondary markets or even primary markets that don't happen to be Los Angeles, New York, San Francisco, Boston, or Washington, the capital has not been anywhere near as available as it was, and there is a heavy reliance on FHA, Freddie, and Fannie still for all the other markets.

Mr. STIVERS. Great. Thank you. Somebody earlier was talking a little bit about—I think it may have been Mr. Calabria. The current FHA downpayment, obviously, it varies depending on your credit score. I think if your credit score is below 580, you have to pay 10 percent down.

Mr. CALABRIA. That is correct.

Mr. STIVERS. I am trying to remember off the top of my head that number. But in the discussion draft, I believe we raised the minimum downpayment to 5 percent regardless of your credit score. And it kind of brings me to the similarity of the QRM too. They have all these stand-alone factors in the QRM, but they don't look at the interplay. They kind of look at as, each of them as hurdles. But they just see if you clear them. And if you clear, for example, the credit score much higher than where the hurdle is, or if you clear the payment ratios higher than where the minimum is, you get no credit for that. I guess my comment is to the discussion draft. Should we look at a way to provide a sliding scale so that if your coverage ratio of payment, ability to make your payment and your credit score is higher that we consider sliding the downpayment.

Mr. CALABRIA. I think absolutely. Let me preface with, I am very uncomfortable with thinking of putting the phrase "FICO" in the statute. There are problems with it. But beyond that, having some interaction between the credit history, debt to income and downpayment, how all those fit together, you should be able to trade off. And again, I favor a 5 percent because quite simply, I don't think FHA has done a very good job about that trade-off in the past and

I think that trade-off is often difficult to get statute. But if you can do that, then again, you lessen the hit.

Mr. STIVERS. I guess my point is, government doesn't do a very good job of pricing risk. But if we could allow that trade-off—and underwriters do it every day, and I see some other folks want to make comments. And we will just go down the line until we have time out because this is really what I would like to spend most of my time on. Mr. Chappelle and then Mr. Petrou and then if anybody down at the end wants to comment.

Mr. CHAPPELLE. Thank you, Congressman. What you have described is basically what underwriting is. If you are going to put more requirements in the statute to shoehorn what is allowed and what isn't allowed, it will just create more complexity, more hurdles, more everything. A good underwriter can make that decision. And then you can evaluate the performance of the lender. And FHA has a database that is public that lets people see how each company is performing. And that is why a lot of them appeared in the papers recently for poor performance. So I think there are enough sticks and carrots and sticks to do it without having to put things in the statute about underwriting requirements because otherwise you are never going to get a loan approved.

Mr. STIVERS. And one of you called for the actual ultimate credit officer who approved the loans for the database to go that far down. Was that your testimony?

Mr. CHAPPELLE. It was the loan originator.

Mr. STIVERS. The loan originator. So that the loan originator, by individual, you could actually track whose loans were performing and whose weren't. I think that is a great idea. Does that require a congressional change or can they do it through a rule?

Mr. CHAPPELLE. They could do it regulatorily.

Mr. STIVERS. That is a great idea. I would like to keep moving down.

Mr. PETROU. I would like to note that historically, FHA actually did have a sliding scale downpayment. If you go back to the glory days of the 1970s, as you increase the borrowed amount, the percentage of the loan that was required to be put down increased. So by the time you got to the top of the FHA limit back in the 1970s, you ended up with having well above a 5 percent minimum downpayment. FHA, as a 3 percent downpayment program, did not exist in the 1970s.

Mr. STIVERS. I am out of time. But how do we do this without giving so much discretion that essentially we have nothing anymore?

Mr. PETROU. I think that the key here is to mix downpayment with coverage level. I don't think FHA should be insuring 100 percent of every loan that it buys.

Chairwoman BIGGERT. The gentleman's time has expired.

Mr. STIVERS. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. The gentleman from Wisconsin, Mr. Duffy, is recognized for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman. I will yield my time to Mr. Garrett.

Mr. GARRETT. I thank the gentleman. And just to close on the other point, I look forward to working with the Chair on the last point that we were discussing, if we can address a way to find out how we can have better transparency and accuracy in the accounting to move from where we are right now to go in a direction maybe not as far as what CBO, is but whatever that correct assessment is. So I look forward to going in that direction.

Secondly, to Mr. Evans a question, your testimony goes on to say that HUD anticipates that demand for FHA multi-family has increased more than fivefold, and the estimates point to a high demand for these programs for the next several years. Can you say how FHA meets this increased demand without sacrificing credit requirements and underwriting that would further expose it to taxpayers?

Mr. EVANS. I am sorry. I missed the question.

Mr. GARRETT. The last part of it, how can FHA meet these increased demands for multi-family without sacrificing credit requirements and underwriting that would further expose all of us to the taxpayers? How can you do that and to meet the demand for multi-family housing increases? Because we are hearing that is where it is working out there.

Mr. EVANS. Exactly. And we are fully behind credit policy. What we are concerned about is really the process. And some of the things that have been implemented, they have taken control out of the local offices and centralized it. One of the points that I brought up in my testimony was that if you have a loan that is over $15 million, the home office has to approve this loan. So giving more authority to the local offices would speed up the process. Also giving more reliance to the multi-family accelerated processing guide, which was implemented in order to speed up the process, a lot of these guidelines' timeframes are no longer adhered to, where you have maximum review periods, 60 days for a 223(f) loan and 90 days for a 221(d)(4) loan, those time frames have been thrown away. So people really don't know where they are at in their application process. Giving more authority to the map lenders and giving more authority to the local offices.

Mr. GARRETT. I appreciate that. Let me just switch gears to something that the Administration had said on another note. Back when the Administration rolled out their GSE proposals, one thing they said—and I think we all agree on this—is that we have to do something with regard to GSEs to make sure that some segment goes back to the private market and that the huge amount that is over the GSEs goes down, and the huge amount that is over the FHA goes down as well. We are all in agreement on that point. The rub comes though with Dodd-Frank legislation. And what does that do? That goes into the whole issue of risk retention, right, which is one issue. But in the risk retention issue, what does it do? It gives an exemption, right, to the GSEs and to FHA.

So some of the people who have sat at this panel say, when you do that, what happens? Basically by giving the exemption over here to GSEs and FHA, you are going to create a disincentive in the private market. Why? Because if you still have the risk retention over in the private sector, they have to do what? They have to hold capital on their books. And that is a disincentive—not only disincentive, it is a higher cost for them. So where do the loans go? When they are coming to you to get a loan, or people who are going through real estate, going through you to get loans, where do they go? They don't go there because it is more expensive. They are going to continue to flow into the FHA, into the GSEs. That is the argument. Is there any basis to that argument?

Mr. CHAPPELLE. Congressman, I think from reading the Administration's White Paper, they make it pretty clear. They want to raise the FHA and GSE requirements so that the private sector is competitive. I personally don't agree with that. But that is what the White Paper says.

Mr. GARRETT. But not in this area. Not on the risk retention area. On the risk retention area, they make an exemption and they make it different.

Mr. CHAPPELLE. They make an exemption in the short term. But it is pretty clear from reading the White Paper, they say, establish a timeline for raising fees, increasing downpayments, and lowering maximum mortgage amounts. So they are on the same page.

Mr. GARRETT. That is interesting. So your reading of that is, create this exemption for today while you have this deal problem. And then maybe phase out that risk retention?

Mr. CHAPPELLE. Right.

Mr. GARRETT. Okay. That is your understanding.

Mr. CALABRIA. While I rarely find myself in defense of the Administration—

Mr. GARRETT. We will mark this down.

Mr. CALABRIA. —in terms of the QRM, I think they are largely following the direction that Congress has given them, which is why I believe you ultimately need to either impose those same restrictions on FHA or Congress needs to outright repeal the QRM. This will drive business in the FHA and the GSEs, which certainly conflicts with the White Paper.

Chairwoman BIGGERT. The gentleman's time has expired.

Mr. GARRETT. Thanks, everybody.

Chairwoman BIGGERT. The gentleman from Illinois, Mr. Dold, is recognized for 5 minutes.

Mr. DOLD. Thank you, Madam Chairwoman. I appreciate that. And thank you all for taking your time to be with us today. I certainly appreciate that.

Mr. Calabria, if I can just continue with you just for a minute. Are there policies or regulations in place currently that are hindering the return of private capital into the mortgage market?

Mr. CALABRIA. I think there are a tremendous number of things that are hindering a return in the private. Obviously, the QRM I think is keeping capital out of the market. I think we need to get some resolution to the foreclosure crisis. Right now, it is not clear. Let me put it this way: I don't know anybody who would rationally want to invest their money in the mortgage market. Would you want mortgage money now, given the risk that is inherent in it?

So I do think we need to get a set set of rules on servicing, on foreclosures, and on what the deal is going to be going forward. Even if you buy GSE debt today, you have no guarantee that essentially you are going to get paid. So there is a tremendous amount of uncertainty. And I think we need to start removing that uncertainty sooner rather than later.

Mr. DOLD. Okay. What do you envision as the proper role of private capital in a functioning market for mortgage lending?

Mr. CALABRIA. I think, ultimately, the principle we should follow is those who get the upside take the potential for the downside. And the biggest underlying problem in our mortgage market I think is the mortgage industry essentially—with all due respect to my friends in the mortgage industry—get to gamble on the upside and the taxpayer takes the downside. I think that risk needs to be aligned in a way so that, again, you take the upside risk, you take the downside risk.

Mr. DOLD. I recognize taking the downside risk. Should there be any safety net in any way, shape or form? Do you think it should just be a strict up or down?

Mr. CALABRIA. I would rather have a strict up or down. I do think we need to recognize something that absolutely seems there is no chance of changing in my mind, which is the Federal Reserve has set a precedent of buying $1 trillion-plus in mortgage-backed securities in a crisis. They seem like they are going to do that next time as well, so you already have a catastrophic backstop in place that nobody seems to be talking about getting rid of, and we should recognize that as part of the debate.

Mr. DOLD. Yes, sir, Mr. Berman?

Mr. BERMAN. Thank you, Congressman. With respect to the upside/downside discussion, I think we need to step back from this. Clearly—and as Mr. Calabria pointed out—there is a lack of confidence in the market, and a lack of confidence in the market is a very broad-based concern. Doing anything that would constrain the ability today to deliver financing to potential homeowners, first-time home buyers and so on, changing the downpayment limits, making it more difficult for people to get FHA financing, I think would be something that would be ill-advised given the fragility. In other words, if we want to bring private capital back to the market, the first thing we have to do is get confidence. We can't legislate confidence. What we need to do is create a base to re-establish homeownership, to make sure that FHA, Fannie, and Freddie can continue to deliver what they have been delivering.

As the economy stabilizes and grows and as homeownership and home values stabilize, private capital will come in. It will come back. FHA had, as has been discussed, a 3 percent market share not that many years ago. Those same kinds of structures can exist. So the key is to not do anything that would have the unintended consequences of upsetting, re-establishing a base today.

Mr. DOLD. Let me just jump down because I know you have had an opportunity. Yes, sir?

Mr. CHAPPELLE. The trouble in the market today is it is widespread. It is not just the government gobbling up the private sector. The government is not doing enough loans either. Combined, Fannie, Freddie, and FHA only did 1.9 million purchase loans last year. And we don't have enough private sector involvement because of that, because all FHA has done—FHA's volume right now is running behind, from a purchase market activity, below what it did in 2000. So it is not like FHA is exploding anymore. Because of the changes the Administration made, raising the premium, their business is falling back, too. But we are just not doing enough loans of any kind, much less whether it is private or public.

Mr. DOLD. If I may just follow up on that comment, why is the private sector not loaning as much? You say they are not loaning as much right now. Why is that? I have heard from others who are saying that the regulators are coming in preventing that, or preventing a more robust loaning environment. Can you tell me your thoughts in terms of that?

Mr. CHAPPELLE. To me, the market has been predominantly a government market for the last—since the Great Depression, because it was portfolio lending by banks which have deposit insurance, so it has always been a government-based market.

What is happening today is lenders, in addition to the rules that are out there, lenders are establishing their own rules on government loans because they are afraid of the risks. So we are getting a glimpse of a private mortgage market today because lenders are even establishing their own rules when they theoretically have 100 percent government insurance.

Mr. DOLD. I appreciate that.

I know, I just have one last question if I may, Madam Chairwoman. And back to you, Mr. Berman.

You and other stakeholders have raised the importance of reforming the GSEs in concert with changes—

Chairwoman BIGGERT. I am sorry, Mr. Dold. Your time has expired. You can submit that in writing, and I am sure they will be happy to answer you.

The gentleman from North Carolina, Mr. McHenry, is recognized for 5 minutes.

Mr. MCHENRY. I thank the Chair. Mr. Calabria, it looked like you wanted to respond to that previous question.

Mr. CALABRIA. Yes, there were a number of pieces of that. And I would say foremost, FHA is not capacity-constrained. If there was more demand for the product, people would be able to meet more of it. What I am getting at is the ultimate driver here is that buyers are sitting on the sidelines because they are massively uncertain about what is going to happen next in the housing market. And part of my concern that we have had very low downpayments in FHA over the last couple of years is, it is fair to say that probably 30, 40 percent of the FHA book of business in 2008, 2009 is underwater today. And if we see continued declines in prices, I think it is reasonable that we will see at a national level another 5 percent, 6 percent decline in prices. So a tremendous amount of FHA going business, we are creating essentially foreclosures of tomorrow, and that is what greatly concerns me.

I want to follow up on Michael's point about yes, I think as we go forward, FHA's business will decline once the market starts to heal. But the way that that is going to decline is for a prime borrower—the price of an FHA is simply not that attractive. And I am concerned that the decline will become in the better-quality borrowers and will go back to an FHA that looks like 2005 where predominantly 60 percent of the business for FHA in 2005 were subprime borrowers. And I fear we are going to get back to that world unless we start making changes today.

Mr. McHENRY. To a greater point here, on the QRM. As I see it, without a role for private mortgage insurance, you are basically forcing this market to maintain a more government-dominated role.

Mr. CALABRIA. That is absolutely the case.

Mr. McHENRY. And I would open it up to the panel, but you can kick it off, Mr. Calabria, and anyone else who would like to comment. I am very concerned that without private mortgage insurance being a part of the QRM, that we are going to crowd people out.

Mr. CHAPPELLE. Absolutely, Congressman. I agree with you. And the point I would make is we are seeing how low downpayment loans can perform well today. I know some of us disagree on this panel, but the FHA performance has been very good since loans originated in 2008 onward are doing remarkably well. I think private mortgage insurance could do equally well, if not better. So I think hopefully, when we can see the performance of the FHA loans, the private mortgage insurance industry should be able to do the same things FHA does.

Mr. McHENRY. Mr. Rutenberg? And then we will come to you, Mr. Petrou, next.

Mr. RUTENBERG. The QRMs, if they come into effect as they are now, have unintended consequences that are going to skew the market terribly. There is not only the 20 percent. They have the PITI at 28 percent, total loan at 36 percent. If you missed any credit card payment in the last 2 years, you are not eligible. We have to have a different way of doing it.

Members of the Senate who were involved in this tell me that what we have now is not exactly what they thought they were going to get. And I hope that it is seriously looked at it, and it evolves or does not come forward as it is.

Mr. McHENRY. So too much rigidity and more prescriptive than it should be, without any sort of level of—

Mr. RUTENBERG. I have seen estimates that 50 to 60 percent of the people who qualified for a mortgage last year could not qualify under QRM in that type of market.

Mr. McHENRY. Mr. Petrou?

Mr. PETROU. I agree the QRM is a real problem. I do think that private mortgage insurance on loans with downpayments below 20 percent should definitely be part of any kind of QRM. I think the private mortgage insurance will come back, but it doesn't have to wait for the FHA or anything else. The problem they have at this stage is the loan level fees that Fannie Mae and Freddie Mac are charging over and above the private mortgage insurance premiums, which in essence push people into the FHA as a consequence of that. I think, really, as I indicated in my testimony, these are many multiple moving parts that have to be thought and worked together.

And I commend the committee for doing this bill because it is very critical that FHA be changed along with the GSEs so that when the final product is put together, we have a new view of what the role of government in the market is, and people will understand that, as opposed to little spot changes which can be very destructive.

Mr. McHENRY. Mr. Berman?

Mr. BERMAN. Thank you, Congressman. The concept of responsible lending and risk, skin in the game by lenders is certainly one that has merit. But having said that, I think that for us to not take into account the private mortgage insurance as having skin in the game who have that overlay of underwriting is a mistake. I think that we should clearly view them as being part of the equation, and the overly prescriptive QRM approach clearly does not give the kind of credence that we have to the multiple factors that go into a responsible underwriting of a loan.

Mr. MCHENRY. Thank you.

Chairwoman BIGGERT. The gentleman yields back. I would ask unanimous consent that the following letters and written testimony be inserted into the written hearing record: May 24, 2011, the National Council of State Housing Agencies letter; May 25, 2011, the National Housing Law Project statement for the record; and May 25, 2011, the Securities Industry and Financial Markets Association statement.

And I would like to thank the members and the witnesses for starting the dialogue on potential reforms to help shape a stronger framework for the future of housing finance. We have had a robust discussion today, with not too many sparks. So I will anticipate that we will have additional subcommittee hearings on reform proposals.

With that, the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. The hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

I would also encourage any of you who really didn't have—it was too late to really include more about the proposals in your statements. If you wish to submit further testimony, we would be very happy to receive that. I think it has been very helpful so far and we are going to continue to work on this. So appreciate your being here.

And with that, this hearing is adjourned.

[Whereupon, at 12:09 p.m., the hearing was adjourned.]

A P P E N D I X

May 25, 2011

Council for Affordable and Rural Housing

Serving the Affordable Housing Needs of Rural America

TESTIMONY OF KATHERINE M. ALITZ ON BEHALF OF THE COUNCIL FOR AFFORDABLE AND RURAL HOUSING

BEFORE THE SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY, HOUSE FINANCIAL SERVICES COMMITTEE

LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS AND GNMA IN THE SINGLE-AND MULTI-FAMILY MORTGAGE MARKETS

May 25, 2011

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LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS AND GNMA IN THE SINGLE-AND MULTI-FAMILY MORTGAGE MARKETS

May 25, 2011

I am the President of the Council for Affordable and Rural Housing, and on behalf of myself and CARH, I want to thank the Committee for the opportunity today to submit written testimony about the importance and need to support federal rural housing programs, and address the draft legislation.

CARH members house hundreds of thousands of low-income, elderly and disabled residents in rural America. CARH has sought to promote the development and preservation of affordable rural housing throughout its 30 year history as the association of for-profit, non-profit and public agencies that build, own, manage and invest in rural affordable housing.

In rural areas throughout the country, there continues to be an overwhelming need for affordable housing. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is also affordable. While the demand for rental housing in rural areas remains high, the supply, particularly of new housing, has decreased. This is in large part due to a reduction in federal housing assistance. Neither the private nor the public sector can produce affordable rural housing independently of the other. It has been and should be a partnership. CARH and its members continue in their commitment to provide safe, decent and affordable housing for individuals who live in rural areas.

My comments will focus on the later portions of the draft legislation, which concern rural housing. As I note below, CARH is very much focused on saving the Section 538 Guaranteed Rural Rental Housing program from elimination. Section 14 of the draft legislation proposes a fee-based system to continue the program. We hope that the Section 538 program revisions move forward with all due speed as projects, and the good housing and good jobs they bring, are waiting to proceed as we speak.

CARH also appreciates the interest in streamlining federal housing program administration. We heard the President in this year's State of the Union address to Congress question why we had multiple housing agencies and that we need to consolidate government operations. We do need to remember that the different federal housing agencies did not develop arbitrarily but in response to different housing needs. Any consolidation of functions must still serve to address the continuing housing needs and the different constituencies.

CARH members continue to review the issue, as there are pros and cons. The notion of moving some parts of Rural Development ("RD") to the U.S. Department of Housing and Urban Development ("HUD") has been a discussion topic in the past, including the 2000 Government Accounting Office study *Rural Housing: Options for Optimizing the Federal Role in Rural Housing Development.* The draft legislation circulated in advance of this Hearing is the first serious legislative proposal we can recall on this topic. As such it merits further discussion among the housing industry and the affected authorizing and appropriating committees before moving forward.

The key is we must make sure that whatever the context, budget support remains with the program functions. There must also be opportunity to not lose the institutional memory built up by certain long term RD employees. One potential benefit of consolidation is to align congressional oversight so House and Senate authorizing and appropriations committees are the same for rural housing as for other housing programs.

CARH believes that certain programs must be continued, albeit in some instances, modified. In rural America, the key rental housing programs have been and remain the RD multi-family programs. RD programs often work in tandem with other federal housing programs but in rural America, RD multi-family housing programs cannot be replaced. The RD single family housing has drawn most of the attention devoted to RD housing programs. The multifamily portfolio, which consists of more than $11 billion in Section 515 loans alone, has for too long been ignored. The collapse of the single family housing markets is strong evidence of the need to strike a balance with rental housing. Now that there appears to be some stability in the market place, we would urge this Committee to refocus on the affordable rental housing stock.

The Administration's FY2012 budget request is notable in that it eliminates one of the most successful and low cost programs currently in use by RD, the Section 538 Guaranteed Rural Rental Housing program. The Section 538 program is limited to low- and moderate-income rural residents though most residents are low or very low income. Qualifying properties include either new construction or acquisition/rehabilitation of existing multi-family properties. CARH strongly supports a program level of at least $129 million.

The Administration's rationale for eliminating this program was that there are duplicative programs at HUD, but HUD does not currently have any programs that duplicate Section 538. HUD's multifamily mortgage insurance programs are designed for larger, more expensive properties than we generally see in rural areas. The HUD multifamily programs are also not compatible with preservation activities for the existing Section 515 RD properties. Both by contract or statute, Section 515 owners cannot freely prepay their mortgage loans, and indeed, RD laws and regulations require preserving these properties. Because of these restrictions, the HUD programs cannot be used to simply prepay or replace the Section 515 loans. The Administration's other rationale was that the Section 538 program was too expensive. However, the Administration's subsidy rate calculations are incorrect and mistakenly overstate costs. Our findings are similar to GAO's recent findings in its March 2011 report "Rural Housing Service, Opportunities Exist to Strengthen Farm Labor Housing Program Management and Oversight", where GAO found that RD overstated the credit subsidy cost for the Farm Labor Housing programs, also known as Section 514 program. The Administration also fails to consider the underwriting changes implemented in FY2005, reducing the subsidy cost.

Notwithstanding the Administration's mathematical errors and factual oversights, we believe the Section 538 program can be rendered revenue neutral or virtually so. Interestingly, the Section 538 statute already allows the U.S. Department of Agriculture ("USDA") the discretion to charge a fee, but appropriations language in each appropriations law since the Omnibus Appropriations Act of 2009 has prohibited RD from charging that fee. We understand that Appropriations language was added by Congress in an effort to help borrowers as an offset for the elimination of interest subsidy in the program. But the unintended consequence is it removed flexibility that already existed in the program. CARH strongly supports Section 14 of the draft legislation, entitled "Guarantee Fees for Rural Multifamily Rental Housing Loans." This Section would restore financial balance to the program while saving federal appropriations.

While the Section 538 program may well be RD's most effective rental housing development and job creating program, the main program that finances existing housing is the Section 515 Multi-Family Rural Rental Housing program which has produced more than 15,000 apartment complexes with more than 400,000 units. This direct loan program is one of the few resources that enable the very low-income and low-income renters in rural America to access decent, safe, and affordable housing. The Section 515 program also reduces homelessness and overcrowding. The demographics of the residents in these complexes are as follows: the average annual tenant income is $10,500; 72% of the households in the complexes are headed by women; 41% are headed by an elderly person; and 26% of the households are headed by a minority. CARH urges Congress to support this program. Historically, the Section 515 program was funded at more than $900 million a year. Today, the 515 budget provides enough maintenance funding to support minimal operations and has been less than $100 million a year. We urge Congress not to cut the lifeline that is left for this program.

The Section 521 Rental Assistance ("RA") Program is an essential component of the Section 515 and 538 programs and is a lifeline for extremely low income rural residents. The program provides deep subsidy to very low-income residents, providing the difference between 30% of a resident's income and the basic rent required to operate the property. The RA program is similar to HUD's Section 8 program, but one major difference is that RA is tied to the Section 515 mortgage and cannot be separated without legislative changes, where Section 8 can be a stand alone funding source.

We are most concerned with the implication in the FY2012 budget of reducing RA to $907 million. That is an unsustainable reduction, which may result in the loss, eviction and anticipated homelessness of residents in some 400 apartment complexes in rural America. RD has openly discussed how it anticipates meeting this numerical reduction by reducing the number of RA recipients—through foreclosure of the Section 515 loans or by pressing for prepayment—and then offering rural vouchers. RD knows that on average two-thirds of residents do not pursue vouchers. It is in residents' vested self interest to pursue vouchers. We believe that elderly, disabled, or over-whelmed residents are simply unable to cope with the voucher processing. The net result surely will be to materially increase homelessness in rural America. Any transfer of functions would certainly have to address such issues.

To the extent that Congress is looking to past funding levels, we believe it is important to explain that RA budgets have not increased in any real sense, though the budget amount has increased. For approximately the past five years, Congress has sought to convert RA contracts from multi-year allocations to single year allocations. This creates a short-term budget savings. Since FY 2009, RA contracts between RD and rental housing owners have been for one year terms. During the prior several years RD converted RA contracts from five-year contracts, then two-year contracts, then one-year contracts. For example, if Congress goes back to FY2008 without adjusting for the budget changes made to realize past budget savings, it will dislocate over 100,000 residents.

Moreover, the conversion to annual contracts has added to the cost of the program cost as operators and RD have to reprocess RA contracts each year. It has also added uncertainty, chilling private capital participation. CARH believes it is important for Congress to authorize RA contracts for 20 years, subject to annual appropriations, to alleviate the administrative burden and uncertainty, without adding to program cost. For FY 2012 CARH urges full funding at the FY 2010 level of $971 million. We also urge in that amount Congress include funding for preservation RA, which allows RD to extend affordability and preserve existing Section 514 and 515 properties.

The Administration's FY 2012 budget request also eliminates the Multi-Family Housing Revitalization Program ("MPR"). The MPR program has operated as a demonstration program since being authorized by Congress in Fiscal Year 2006. The intended effect of the MPR program is to restructure selected existing Section 514/515/516 loans and grants expressly for the purpose of ensuring that sufficient resources are available to preserve the rental complexes for the very low, low and moderate income residents who live in these complexes. Expectations are that properties participating in this program will be revitalized and the affordable use will be extended without displacing residents because of increased rents. The Administration's budget justification states that owners are able to prepay their Section 515 loans. This is false and contradicts court precedent and RD's own regulations. The Administration also uses as a justification that MPR has funded the most cost-effective repairs. This too is false. There is nothing remarkable to distinguish the approximately 400 MPR approvals to date from more than 15,000 other Section 515 projects. Owners who participate in MPR receive no benefit, no fees and in fact must navigate complicated income tax issues that result from any mortgage restructuring. MPR is a difficult program but an important tool for some properties to protect residents. CARH supports permanent authorization and we suggest this can be achieved on a revenue neutral basis. Our suggested permanent authorization language is as follows:

> ()In General. The Secretary is authorized to make available financial assistance for the preservation and revitalization of the Section 514, 515, and 516 multi-family rental housing properties to restructure existing USDA multi-family housing loans and grants, for the purposes of ensuring the project has sufficient resources and to preserve the project for the purpose of providing safe and affordable housing for eligible residents.
>
> ()Assistance. Such assistance may include, but not be limited to:
>
> () reducing or eliminating interest;
> () deferring loan payments;
> () subordinating debt to new debt from the Secretary or other agencies or parties;

() reducing or re-amortizing loan debt; and
() other financial assistance including advances, payments and incentives (including the ability of owners to obtain reasonable returns on investment).
()Long term use. The Secretary shall as part of the preservation and revitalization agreement obtain a restrictive use agreement consistent with the terms of the restructuring. Such term shall not be less than 30 years from the provision of execution of the agreement.
()Fee. The Secretary may approve and collect a fee from a participating owner, equal to no more than 10% of the cost of the assistance to that owner under this program.
() Existing Authority. The Secretary presently has issued regulations that include some of these forms of assistance, but not as part of this program. Nothing herein shall be construed as limiting the Secretary's existing authority in any way.

We appreciate the Committee's efforts to balance the needs of rural America's elderly, disabled and working poor with our ongoing budget issues. The rural programs have been and remain our most efficient federal rental housing programs and a resource rural America cannot afford to lose. We understand that the RD Under Secretary has been emphasizing RD's business programs and business development in rural communities. We appreciate the emphasis on business because rural housing preservation creates the same kinds of good construction jobs as RD business programs and also provides a place for people who work in businesses to live. However, housing needs to be re-established as a rural priority.

MORTGAGE
BANKERS
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Investing in communities

Testimony of

Michael D. Berman, CMB
Chairman
Mortgage Bankers Association

House Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

"The Future Role of FHA and GNMA in the Single and Multifamily Mortgage Markets"

May 25, 2011

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)[1] on the roles of the Federal Housing Administration (FHA) and the Government National Mortgage Association (Ginnie Mae) in the single- and multifamily mortgage markets. My name is Michael D. Berman, CMB, and I am the current Chairman of MBA. I have been in the real estate finance industry for over 25 years and am a founder and member of the Board of Managers of CW Financial Services. I also serve as President and Chief Executive Officer of CW Capital. Headquartered in Needham, Massachusetts, CW Capital is one of the top 10 lenders to the multifamily real estate industry, with $3 billion in annual production and over 150 employees in 12 offices throughout the country. My responsibilities include overseeing the strategic planning and operations for all of the company's loan programs, including multifamily programs with Fannie Mae, Freddie Mac, and FHA. CW Capital has been active in the commercial mortgage-backed securities (CMBS) arena as an investor, lender, primary servicer and issuer of securities. Additionally, CW Capital is a special servicer of approximately 20 percent of the CMBS market.

FHA and Ginnie Mae are essential elements of the American housing finance system and are especially important to segments of the population who need a little extra help in securing safe, decent affordable housing – whether through the American dream of homeownership or the foundation of affordable rental housing.

More than any other national program, FHA focuses on the needs of first-time, minority, and low- and moderate-income borrowers. According to recent data provided by the Department of Housing and Urban Development (HUD), both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. As of April 2011, approximately 77 percent of FHA-insured home purchase loans were made to first-time homebuyers, and 31 percent of these first-time homebuyers were minorities. Minorities also comprise a higher percentage of the FHA market than the conventional mortgage market.

In the early 2000s, there were discussions among policymakers about whether FHA was truly necessary, or if the private sector could assume its functions. The significance of FHA and Ginnie Mae in the housing finance system has been underscored, however, with the recent mortgage crisis that began in late 2006 and resulted in the retreat of the private sector and an illiquid mortgage market. FHA's counter-cyclical role has proven invaluable to maintaining liquidity in the single family,

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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 280,000 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 2,400 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.

multi-family, and healthcare markets and has helped buttress the country's unstable housing finance system. With the contraction of the private sector, FHA's market share has grown to almost 30 percent of all loan originations and has reached as high as 50 percent in some geographic locations in 2010, and almost 50 percent of all purchase mortgages in the country. Temporary higher loan limits of $729,750 for one-unit properties in high-cost areas helped increase this market share. FHA was also responsible for 21 percent of multifamily and healthcare mortgages originated in 2010.

In this time of crisis and increased defaults, FHA had to redouble its efforts to protect the Mutual Mortgage Insurance (MMI Fund), which supports the main single family programs. FHA made a series of single family risk management and lender oversight and enforcement changes over the last two years designed to protect the financial stability of FHA. Single family changes included restructuring the mortgage insurance premiums, increasing down-payment requirements from 3.5 percent to 10 percent for borrowers with credit scores below 580, eliminating FHA's approval of loan correspondents, raising lender net worth requirements in all programs, and establishing the Office of Risk Management for all FHA programs. MBA commends HUD and FHA's leadership for taking proactive measures in order to ensure that a taxpayer bailout is not necessary. The most recent Actuarial Report released in November 2010, shows the MMI Fund at 0.50 percent, but expects the capital reserve ratio requirement of two percent to be met in 2014. The report estimates that FHA will meet its capital reserve requirement in 2015, without any additional policy changes.

The recent crisis also put a spotlight on the importance of FHA to multifamily rental housing. One in every three households lives in rental housing, and over the course of a lifetime many more will rent at one time or another. Rental housing supports those going to school away from home, relocating to find work or choosing to rent in retirement, 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. In its report to Congress, "Reforming America's Housing Finance Market," the Obama administration made an important commitment to affordable rental housing and to FHA's central role in meeting that commitment.

MBA has always been a proponent for a strong and vibrant FHA and Ginnie Mae. We called for updates and enhancements to FHA's risk management, scope and operations well before the current market disruptions reestablished FHA's prominence as a catalyst for bringing liquidity to the housing finance system. In the last Congress, the association supported H.R. 5072, the FHA Reform Act of 2010, which overwhelmingly passed the House. Although H.R. 5072 did not pass the Senate, one of the most important provisions in the bill, raising the annual insurance premium cap to 155 basis points (bps), was enacted as part of H.R.5981, thus enabling FHA to restructure premiums, stabilize its finances, and potentially reach the two percent capital reserve fund goal in a shorter timeframe. Because of the annual insurance premium increase of 25 bps last month to 110 or 115 bps (depending on the loan-to-value ratio), the positive results in the General Insurance/Special Risk Insurance (GI/SRI) Fund, as well as other reforms, the president's current budget reflects estimated FHA offsetting budgetary receipts of $9.8 billion in FY2011. Moreover, the president's FY2012 budget projects FHA and Ginnie Mae to generate, collectively, more than $6 billion in receipts that will help rebuild FHA's capital reserves and offset HUD's gross budget request of $47.8 billion.

Notably, FHA is not only generating revenue, but is also improving the quality of its book of business. According to FHA's April 2011 data, the average credit score for all transactions was 703, six points higher than a year ago. The serious default rate was 8.2 percent, lower than the 8.8 percent reported a year ago. These indicators give MBA comfort that FHA is moving in the right direction.

MBA believes FHA's dramatic growth and corresponding need to maintain the MMI Fund make it imperative that we enact thoughtful and appropriate measures to preserve the agency's strength and viability now, and over the longer term. Protecting and improving FHA requires a multifaceted approach to both the single family and multifamily businesses: ensuring that FHA has the right resources; creating credit policies that are both prudent and aligned with FHA's mission; requiring high eligibility standards for lenders; and ensuring that FHA is helping to provide market liquidity during times of crisis. The tools that Congress has already given FHA and the policy changes that FHA has made to date position FHA to continue on a course to fiscal stability.

An outstanding issue that will have a dramatic impact on FHA and Ginnie Mae is the future of the government sponsored enterprises (GSEs). As the housing market begins to stabilize and the debate intensifies over the new configuration of the country's housing finance system, policymakers are now faced with the question of how to transition FHA back to a state of normalcy without dramatically disrupting the housing recovery. The release of the Obama administration's white paper renewed the discussion of how best to wean the country of its dependency on a government-supported housing industry. Recommendations for how to scale back government involvement in the housing sector range from an extremely limited role, focused solely on FHA and the other government housing programs, to a broader framework that would allow for a catastrophic government backstop for a portion of the conventional market. The report recognized that the foundation of the housing market is still not strong and that the return of the private sector and regulatory certainty for lenders are keys to a smooth transition.

MBA supports a gradual reduction of government involvement, and is committed to supporting FHA through this transition and providing it with the support it needs to remain a viable, relevant component of the housing finance system and continue to provide housing opportunities for millions of Americans.

Throughout this transition, FHA should ensure that it balances appropriate risk management, sustainable homeownership, increased need for rental and healthcare housing, and support for the housing market recovery. Policies that are too constricting over too short a period of time would not allow businesses the flexibilities that are necessary to revive the housing market and provide reasonably-priced credit to responsible borrowers.

MBA believes FHA's importance to the housing finance market make it imperative that policymakers act thoughtfully to preserve the agency's strength and viability now, and over the longer term, without hindering the progress of the housing recovery. We appreciate Congress' commitment to FHA. Also, MBA has received and is analyzing a new draft FHA bill, the FHA-Rural Regulatory Improvement Act of 2011. After a thorough review, MBA will present formal comments to the amendments outlined in the bill.

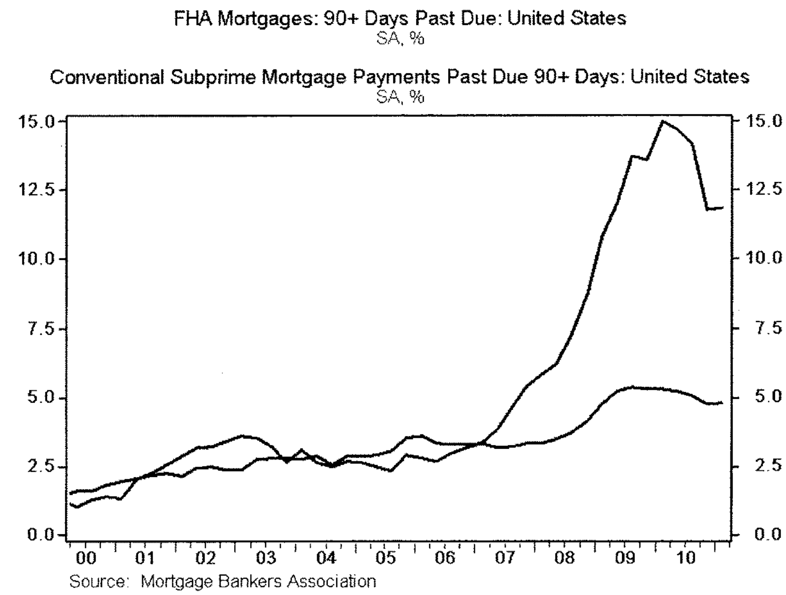
MBA makes the FHA single family and multifamily and Ginnie Mae recommendations below that are intended to fortify their financial foundations, continue affordable housing missions, and assist in a smooth transition to a normalized housing market.

MBA's RECOMMENDATIONS FOR FHA SINGLE FAMILY

Maintain the Current Minimum Down payment

A critical component of FHA's mission is to maintain the affordability of homeownership. The current minimum down-payment of 3.5 percent for borrowers with credit scores of 580 or above and 10 percent for borrowers with credit scores of 579 and below permits borrowers to have appropriate "skin in the game" while providing credit-worthy homebuyers with an option for entering the purchase market. Maintaining the existing minimum down-payment requirements, while requiring strong underwriting standards, such as full documentation and income verification, allows borrowers to responsibly become, and stay, homeowners.

Recently, policymakers have focused on required minimum down-payments as a measure of what factors are necessary to create sound lending practices. While down-payment certainly impacts default risk, other compensating factors, particularly full documentation of conservative loan products, are more influential mitigating factors. Importantly, FHA's requirement of full documentation of all loans and limited loan product options helped insulate the MMI Fund from experiencing the devastating default rate during the height of the housing crisis. As the chart below illustrates, for most of the past decade, FHA loans have performed better than subprime loans, with the exception being the years where FHA problems were dominated by the now defunct Seller-Funded Down payment Assistance Program. Over the course of the crisis, delinquency rates on subprime loans have far exceeded rates on FHA loans.



FHA's traditional business has typically performed well and its product, credit, and documentation standards have been important contributors to this solid performance. Policymakers need to carefully weigh their desire to decrease risk by raising minimum down-payment versus the certain and dramatic negative impact on the availability of loans to low-to-moderate, first-time, and minority homebuyers if FHA raises its down-payment requirement. Analysis has shown that the risk from low down-payment loans can be mitigated by compensating factors, such as documentation and borrower credit[2].

Another outstanding issue that will have a profound impact on FHA is the proposed risk retention rule. The Dodd-Frank Wall Street Reform and Consumer Protection Act require mortgage securitizers to retain five percent of the credit risk unless the mortgage is a Qualified Residential Mortgage (QRM). The proposed rule recently issued by six federal regulators would require families to make a 20 percent down-payment and meet other stringent requirements. It is not at all clear from the proposal whether the regulators reflected on the relationship between the proposed QRM definition and the

[2] "U.S. RMBS Rating Methodology and Assumptions for Prime Jumbo, Alternative-A, and Subprime Loans." Standard and Poor's. 2009

FHA's eligibility requirements in light of FHA's statutory exemption from risk retention. The proposed QRM definition appears to conflict directly with the Obama administration's plan for reforming the housing finance system, as it would make it more difficult for private capital to re-enter the housing finance market. In its white paper, the administration made clear that it intends to shrink FHA from its current role of financing one-third of all mortgages, and one-half of all purchase mortgages.

We support FHA's role as a source of financing for first-time homebuyers and other underserved groups. However, because of the wide disparity between FHA's down payment requirement of 3.5 percent and the QRM's requirement of 20 percent, MBA is concerned that the FHA programs will be over-utilized. While FHA should continue to play a critical role in our housing finance system, MBA firmly believes that it is not in the public interest for a government insurance program like FHA to dominate the market, especially if private capital is available to finance and insure mortgages that exhibit a low risk of borrower default.

Increased Resources and Operational Efficiencies

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, high-tech real estate finance industry. FHA's staff levels have remained virtually unchanged, even though its market share has risen from three to over 30 percent. This ratio of activity to resources stretches FHA beyond its capacity. In the prior Congress, MBA strongly supported H.R. 3146, the 21st Century FHA Housing Act, which would have provided FHA with up to $72 million in funding to hire additional staff and upgrade compensation to be commensurate with that of other federal financial regulators.

MBA supports FHA's FY2012 budget request of 92 additional FTEs compared to FY2010 enacted levels. The association also questions whether the current appropriations practice of dividing HUD's salaries and expenses among multiple sub-accounts, with limited transfer and reprogramming flexibility, is the most efficient and effective structure. MBA supports the proposal in HUD's FY2012 budget to restructure the Executive Direction account by removing sub-function allocations to provide HUD with the flexibility to respond quickly to emerging or unanticipated needs as they arise. Additionally, MBA agrees with HUD that Congress should explore providing additional administrative flexibilities in accounts funding salaries and expenses across the department, so that resources can be easily deployed where they are most needed.

MBA also strongly supports funding to upgrade technology to improve operational efficiencies. New technology would enable FHA to better monitor lenders, protect against fraud, and generally be better equipped to handle the challenges of a modern marketplace. An example of how FHA could modernize its technology for the betterment of consumers and lenders is by permitting the use of electronic signatures for all mortgage origination forms required by FHA. E-signatures, acceptable under federal law and by FHA on certain documents, would help reduce processing issues that impair the home-buying process. E-signatures would reduce the volume of lost paperwork, reduce the time required to close a loan, lower borrower costs, and reduce signature fraud. MBA has requested that FHA implement a revised policy accepting the use of e-signatures on all of its loan documents.

Restore HUD Counseling Funding

Earlier this year, H.R. 1473, the FY2011 Continuing Appropriations Act, eliminated $88 million in counseling funds, which directly impacts first-time homebuyer counseling and counseling for reverse mortgages for seniors. The president's FY2012 budget includes $88 million for the Housing Counseling program and MBA urges Congress to restore these funds.

HUD expects the majority of the requested funds to be distributed competitively to national and regional intermediaries, local housing counseling agencies, multi-state agencies, and state housing finance agencies to directly support housing counseling services, including pre-purchase, foreclosure prevention, and reverse mortgage counseling. The funds support the delivery of a wide variety of housing counseling services to potential homebuyers, homeowners, low- to moderate-income renters, and the homeless. Counselors provide information to help households improve their housing conditions and choices, avoid foreclosure, and understand the responsibilities of tenancy and homeownership. During FY2010, HUD-approved counseling agencies provided housing counseling services to approximately 3.04 million households, using both HUD and non-HUD funding.

Although the funding cut hurts all borrowers, seniors are particularly impacted because Congress mandated that reverse mortgage counseling was a requirement for receiving a reverse mortgage. Congress has now eliminated the funding for this requirement. Moreover, because FHA policy bars lenders from paying for reverse mortgage counseling (to eliminate any conflict of interest); the reverse mortgage counseling fee becomes the borrower's responsibility. Policymakers determined that borrowers of reverse mortgages needed mandatory counseling because of the complexity of the product and because the product serves a vulnerable population, yet Congress have removed the funding that ensures this intent is carried out. Regrettably, the result will be that seniors who need the proceeds of a reverse mortgage the most will be the ones least likely to afford the counseling fee. Eliminating funding for counseling is a set-back for seniors who are trying to maintain a decent standard of living in these tough economic times.

Loan Correspondents "Table Funding"

As of January 1, 2011, HUD stopped approving loan correspondents. A phase-out period was granted until March 31, 2011, to allow loan correspondents to work through their pipelines; however, the new policy is now in effect. While this requirement was intended to hold approved mortgagees responsible for the origination of their loans and improve risk management, an unfortunate unintended consequence of the new rule has been to shut down the practice of table funding.

Table funding is a financing option that allows originators approved for wholesale lending to originate process and close loans in their name. At the time of closing, the loan is transferred to an FHA-approved lender and that lender simultaneously advances the funds for the loan.

The prohibition of table funding was never HUD's intention, and the department sought to correct it during the prior Congress through a narrow amendment contained in H.R. 5072, the FHA Reform Act. Section 13 of that legislation, which passed the House 406 to 4, would have permitted the practice of table funding to continue.

The new HUD rule has had an immediate negative impact on the availability of credit to FHA borrowers. Lenders rely on the efficient process of allowing qualified correspondents to close loans in their own names in order to serve all markets effectively. Because correspondents are unable to close loans in their own name, many of them have ceased offering and originating FHA products, thus reducing the availability of safe and affordable mortgages and refinancing options for low- to moderate-income and first-time homebuyers. Rural areas, in particular, have been negatively affected, as these communities are typically served by smaller community banks that rely on table funding.

HUD supports permitting loan correspondents to close loans in their own names. Allowing this practice would not reduce the liability of the FHA-approved mortgagee for its correspondents or the overall underwriting quality of the loans, nor would it jeopardize the financial stability of FHA. The FHA-approved mortgagee would still be held responsible for the quality of its loans and would bear the risk of approving and monitoring its sponsored correspondents. Moreover, permitting correspondents to close loans in their own names would align FHA policies with those of Fannie Mae and Freddie Mac.

In this fragile housing market, the real estate finance industry supports measures that will encourage a continued and sustainable housing recovery. Permitting correspondents to close loans in their own names is an important part of that effort. MBA would strongly encourage Congress to take action on this issue as soon as possible to restore any market disruption.

Transition from Temporary Single Family Loan Limits

The maximum loan limits for Fannie Mae, Freddie Mac, and FHA are currently $417,000 with a temporary limit of up to $729,750 for one-unit properties in high-cost areas. The temporary high-cost area limit was first set in the Economic Stimulus Act of 2008, and was extended in subsequent legislation. It expires on September 30, 2011. Without the extension, the high-cost loan limit ceiling would revert back to the limits established under the Housing and Economic Reform Act (HERA), a maximum of $625,500 in high-cost areas.

The Obama administration stated in its white paper that it will not support another extension of the higher loan limits and MBA understands that many in Congress agree with this position.

MBA believes the higher limits should be maintained until the housing market stabilizes and the private market shows more signs that it has returned. We believe that careful consideration should be given as to whether the housing market is ready for a change in the loan limits.

Importantly, if Congress elects to provide another temporary extension to the higher loan limits, MBA would urge that legislation be enacted well before October 1, 2011, in order to avoid certain market disruptions that will, because of rate locks, occur within 90 days of the current limits expiring. In an effort to manage pipelines and ensure timely closings, lenders will begin to curtail originations of higher limit loans in anticipation of the policy change.

MBA's RECOMMENDATIONS FOR FHA MULTIFAMILY

Increase Multifamily Loan Limits
FHA's statutory limits for multifamily financing, while sufficiently high in most markets, are severely restricting the ability of rental property owners in high-cost urban markets to use FHA insurance programs. In the prior Congress, MBA worked with the House to pass H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act of 2009, on September 15, 2009, and as an amendment to H.R. 5072 on June 10, 2010. These bills, along with S. 3700, which was introduced in the Senate on August 4, 2010, would have increased the FHA loan limits for elevator properties in extremely high-cost areas. Because many MBA members originate loans in markets with higher labor, material, regulatory and land costs, there is a gap between the mortgageable amount needed to finance construction or substantial rehabilitation of units in the nation's major cities and HUD's statutory loan limits for multifamily properties. High rise elevator buildings also serve the senior population, especially in older urban markets. MBA strongly supports additional discretion to be given to the HUD Secretary to be used in extremely high-cost areas (similar to that provided in Alaska and Hawaii today).

Fundamental Changes in FHA's Multifamily Program Procedures
As it did in 2010, MBA supports in principle the major risk management initiatives that FHA implemented for its multifamily programs. Effective September 2010, FHA raised the minimum debt service coverage and lowered maximum allowable loan ratios for insurance applications on market rate multifamily projects. FHA's planned initiatives include a more robust mortgage credit review of borrowers, a more standardized approach to due diligence by the lender, and an increase in lender credentials by virtue of a significant increase in required net worth. Over the long run, these changes should strengthen FHA's GI/SRI Fund.

FHA's multifamily and healthcare insurance programs have proven to be indispensible tools for stimulating financing of rental housing production and preservation. While the nation has witnessed the importance of a strong, stable multifamily finance market, less visible has been the role FHA plays creating standards for rental housing, promoting mobility for the workforce, and increasing private capital's investment in our neighborhoods. FHA's seniors housing and healthcare programs have found new niches as the need for affordable rental housing choices for seniors grows.

In many markets, FHA has become a central source of financing for the development of rental housing. The momentum that FHA built up in 2010 continues in 2011. But the ramp up has exposed structural deficiencies in FHA's multifamily application process, leading to a back log of requests. Even today, FHA simply cannot respond to many of these requests.

In the months just before the effective date of FHA's changes in multifamily underwriting, FHA received an unprecedented surge in applications. This surge was an unintended consequence of HUD's procedures. When HUD announced its risk mitigation initiatives in February of 2010, it needed five months to codify them in a formal notice letter to its mortgagees. This formal notice required HUD to give the market 60 more days before the new rules took effect, and any application submitted within those 60 days would be considered under previous, more generous guidelines. With few other sources available for construction/rehab financing and credit tight for refinancing maturing debt on apartments, the pipeline became overloaded.

This situation is a prime example of how FHA's approval process is out of sync with the changes in the market. Coupled with a very long process, FHA cannot start or stop its application process without the long lead times its regulations require to develop and implement program changes. To make matters worse, HUD staff resources have declined. By 2010, the multifamily staff shrank by 15 percent from 2008.[3]

Operational Inefficiency and Risk

FHA's importance to the multifamily and senior housing finance markets make it imperative that policymakers and HUD act to preserve the agency's strength. A priority for the MBA is to see that HUD takes the necessary steps to make FHA's multifamily and healthcare programs efficient and effective. The obstacle that stands between FHA's current state and viability is the agency's ability to execute efficiently.

We believe FHA and HUD need to take three steps:

1. Link HUD's strategic goals to their multifamily credit policies.
2. Dramatically improve FHA's business processes.
3. Improve technology and reporting systems and upgrade staff training.

[3] U.S. Department of HUD newsletter, February 10, 2011, Washington, D.C.

The first step is for FHA and HUD to get ahead of the back log of applications with clear credit policies, and to accomplish that their policies must link to their strategic goals. Credit policies have had difficulty keeping pace with the surge in applications and new types of rental projects under consideration for funding. Many applications are for mixed use projects, combining residential and non-residential uses within a single project. Many projects are in urban markets, adjacent or near transportation systems, but because of the backlog, the strategic benefits of mixed-use projects and transit-oriented development are not realized.

The second step is that FHA needs to improve its business processes. MBA believes FHA can be more efficient. At a time when getting more resources for its multifamily and healthcare programs is very difficult, FHA currently lacks the authority to effectively allocate existing resources. The unique needs of the new pipeline are challenges, taxing existing resources in place. The practical impact of this creates an even longer regulatory implementation process. This adds time to the application process, which adds time and cost to the business decisions that lenders and their borrower clients have to make. Consequently, FHA has difficulty meeting the primary needs of multifamily developers and private investors.

The third step involves dramatically improving the reporting systems and staff training at FHA. The priority of addressing the processing back-log has pushed off implementation of key risk mitigation initiatives. This has contributed to an underinvestment in technology and training. FHA needs a new generation of reporting systems and improved training to manage risk and improve processing times. HUD staff needs extensive underwriting and risk management training in the next generation of multifamily and healthcare projects it is being asked to insure.

MBA'S RECOMMENDATIONS FOR GINNIE MAE

Successful Approach to Risk Management

With respect to Ginnie Mae, MBA commends the way it has served as a stabilizing force during the housing finance crisis. We believe part of its success stems from its unique business model and the value its securities bring to investors, lenders and consumers.

Ginnie Mae's business model mitigates taxpayers' exposure to risk associated with secondary market transactions. Ginnie Mae does not originate or invest in mortgage loans or MBS directly so it has no active retained investment portfolio. Additionally, Ginnie Mae does not take on borrower credit risk or rely on credit derivative products to hedge. Because Ginnie Mae has no need to finance whole loans or MBS portfolios, is does not carry significant long-term debt on balance sheet.

Ginnie Mae is insulated by several layers of protection before it faces any risk associated with the mortgage collateral underlying the securities. Ultimately, before Ginnie Mae's guaranty is at risk, three levels of protection must be exhausted:

1. The borrower's equity in the property collateralizing the loan;
2. The insurance provided by the government agency that insured the loan; and
3. The corporate resources of the lender that issued the security.

Additionally, Ginnie Mae's losses are limited to either the cost of transferring the portfolio or to any decline in the servicing value of the portfolio.

Ginnie Mae's business model also partitions the risk associated with creating and originating securities into three parts: the primary credit risk is held by FHA, the Department of Veterans Affairs, and the United State Department of Agriculture; Ginnie Mae holds the bond insurance risk; and investors hold the interest rate risk. Diversifying risk in this manner is a contributing factor to Ginnie Mae's ability to weather the recent financial storms. The past two years have demonstrated that when a tidal wave of risks results from a systemic financial crisis, it is difficult for one entity to manage all of those risk factors.

Greater Flexibility and Resources
Ginnie Mae has performed well despite its limited resources for salary and expenses. Rising to the challenge posed by the recent economic crisis has been challenging for the organization given its small staff of slightly more than 80 people. That is why the administration's FY2012 budget request for Ginnie Mae provides flexibility that enables greater capacity, service, and protection to taxpayers, without requiring additional appropriations. In light of Ginnie Mae's vastly increased market share (from four percent to over 30 percent in the past few years) and a guaranty portfolio that now tops $1 trillion, the FY2012 request proposes to fund its personnel expenses through Commitment and Multiclass fees rather than through a separate appropriation for personnel compensation and benefits. This will allow Ginnie Mae to increase its staff level to strengthen risk management and oversight.

MBA notes that even though this financing approach affords Ginnie Mae more flexibility in funding its critical personnel and administrative needs, importantly, Congress will retain its role in determining Ginnie Mae's annual funding. However, with receipts accumulating in Ginnie Mae's program account, a ready source of funding will be available to help the agency fund both current needs along with contingencies that may arise in the future. It is critical that the agency have this additional flexibility to be able to respond to market needs and to continue to effectively and responsibly bring global capital into the American housing finance system.

Conclusion
MBA appreciates that FHA and Ginnie Mae are performing the countercyclical roles for which they were created by ensuring a stable, liquid and affordable source of housing finance during this difficult time in the housing market. We look forward to working with Congress, FHA, and Ginnie Mae to continue striving toward the proper balance between prudent risk management practices and providing assistance to qualified borrowers. Thank you again for the opportunity to share MBA's views.

Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, CATO Institute
Before the
Subcommittee on Insurance, Housing & Community Opportunity
House Committee on Financial Services
On "The Future Role of FHA, RHS, and GNMA in the Single- and Multi-family Mortgage Markets"
May 25, 2011

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent seven years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance. Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. He has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He holds a doctorate in economics from George Mason University. http://www.cato.org/people/mark-calabria

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Chairman Biggert, Ranking Member Gutierrez, and distinguished members of the Subcommittee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the CATO Institute, a nonprofit, non-partisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the CATO Institute. In addition, outside of my interest as a citizen, homeowner and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

Need for Reform

Since the end of 2007, FHA's reserves have declined from $22 billion to currently around $3.5 billion. While some decline is to be expected, given the bursting of the housing bubble and continued weakness in the labor market, further declines could easily erode the remaining reserves and require a direct appropriations to cover future claims.

The potential for a bailout of FHA is not a remote possibility. According to the FY2010 Actuarial Review, the net present value of future cash flows from FHA's current book of business is a *negative* $25.4 billion. The FY10 Actuarial Review projects a positive economic value for FHA solely on the basis of assuming that future business will generate revenues sufficient to cover imbedded losses. In order for that assumption to turn out correct, the credit quality of FHA's lending must be improved considerably. It should be noted that a critical assumption driving the positive expected value of future business is the continued prohibition of seller-financed down-payments.

Although FHA's market-share was relatively small during the height of the housing boom, that did not protect FHA from guaranteeing loans that currently have a negative net present value. Values for the FY06 book are a negative $1.6 billion. Of course, this becomes relatively small when compared to the FY08 (-$7.8 billion) and FY09 (-$6.6 billion) books of business. These values also depend heavily on what I believe are relatively optimistic projections for the housing market. Further price declines will dig these holes even deeper.

As FHA guarantees the credit risk on mortgages that underlie GNMA securities, FHA bears the majority of the risk. Interest rate risk is transferred to the investor. Accordingly, most of my testimony will focus on FHA's Single Family 203(b) program.

Programs costs should be accurately priced

If there is any lesson we should take away from the recent financial crisis, it is that when borrowers, lenders, investors and governments do not face the actual costs of their decisions, such decisions are likely to have negative consequences. FHA, and its Congressional oversight, have long suffered from poor decision-making due to gross underestimates of cost.

First among those is that FHA premiums are not structured to cover the administrative costs (including salaries) of running FHA. No private business would last long if it did not price to cover the costs of its employees. Such costs for FHA are covered by appropriations that directly come at the expense of the taxpayer. In recent years, these costs have averaged about $350 million. Given that FY10 insurance-related cash flows were approximately a *negative* $510 million, excluding administrative costs underestimates current negative cash flows by at least 40 percent.

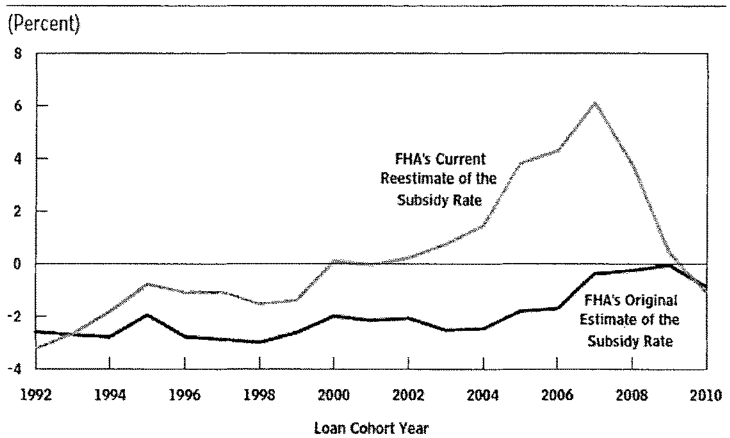
Subsidy rates for FHA are calculated under procedures specified by the Federal Credit Reform Act of 1990 (2 USC 661). In addition to excluding administrative program costs, FCRA excludes any adjustment for market risk. Under insurance programs, such as FHA, where the private sector pays to transfer risk-bearing to the government, the private sector is also protected from market risk. A clear benefit is being provided that is not included under FCRA. CBO has estimated that calculating FHA's subsidy costs under a fair value method – which CBO believes "provides a more comprehensive measure of the cost" – would shift an expected budgetary savings of $4.4 billion in FY12 to a budgetary cost of $3.5 billion.[1] It should be noted that fair value accounting has been used in other federal contexts; for instance Section 123 of the Emergency Economic Stabilization Act of 2008 requires the Treasury Secretary to take into account market risk in the context of the Troubled Asset Relief Program.

When one ignores administrative expenses and fair value, FHA has long been presented as "making money". Yet these assumed "negative subsidies" were based upon erroneous estimates on the part of FHA. A comparison of original estimates and subsequent re-estimates of FHA subsidy rates for the 203(b) program show that from 1999 to 2011 actual subsidy costs were revised upward by a net total of $44 billion. These re-estimates have been large enough, in the years from 2002 and 2009, to change "negative subsidies" into actual positive subsidies. As the following chart clearly illustrates, the errors in FHA's subsidy estimates have been quite large. For instance, the FY06 book was initially projected to create cash equal to 2 percent of book. Upon re-estimate, FY06 actually cost FHA over 4 percent of its book. An error that has costs billions. The chart

[1] Congressional Budget Office. Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair-Value Basis. May 18, 2011.

also illustrates that the bias of estimates has consistently been in one direction: the underestimation of costs.

FHA's Original Estimates and Reestimates of Subsidy Rates for Its Single-Family Mortgage Insurance Program, by Loan Cohort Year



Source: Congressional Budget Office based on data from Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2012: Federal Credit Supplement* (February 2011).

Notes: The subsidy rate is the dollar amount of the federal subsidy expressed as a percentage of the dollar amount of mortgage principal guaranteed. The subsidy rate shown for each "loan cohort year" is the rate estimated for the group of loans disbursed in that year.

Given the gross under-pricing of actual risk by FHA, I urge the following changes to made to FHA's premium pricing:

- Require charged premiums to cover projected administrative costs, including employee compensation.
- Require charged premiums to be estimated on a Fair Value basis.

Towards Sustainable Homeownership

The performance of FHA single-family mortgages during the last decade at times made sub-prime lending look safe. For 2002 to 2007 the delinquency rate of FHA mortgages actually exceeded that of sub-prime. This should of course come as no surprise given that in the 2005 book of business about 60 percent of FHA borrowers had FICO scores under 640. Until 2004, FHA did not regularly collect credit scores for its borrowers. Once it began the collection, it readily became apparently that FHA was one of the largest sources of credit for sub-prime borrowers. In 2009, the credit profile of FHA borrowers improved considerably, raising the expectation that future books of business may see a reduced incidence of loss.

Distribution of Originations by Credit Score Category[a] (Percentage of Fully Underwritten FHA-Insured Mortgages by Dollar Volume)								
Books of Business	Missing	300-499	500-559	560-599	600-639	640-679	680-850	Not Collected
1995	3.25	0.02	0.32	0.76	1.46	1.77	3.51	88.90
1996	3.92	0.03	0.71	1.89	3.81	4.51	8.24	76.89
1997	2.37	0.19	1.39	2.56	4.17	3.98	5.60	79.75
1998	1.80	0.24	1.84	3.18	5.23	4.70	5.51	77.50
1999	1.71	0.22	1.83	3.32	5.40	4.66	4.99	77.87
2000	1.89	0.33	2.44	3.47	5.00	4.01	4.01	78.85
2001	1.37	0.27	2.14	3.31	4.64	3.78	3.92	80.58
2002	1.33	0.31	2.33	3.58	5.09	4.21	4.57	78.58
2003	1.45	0.32	2.69	4.29	6.18	5.18	5.63	74.27
2004[c]	3.03	0.51	4.94	8.65	12.59	10.44	11.71	48.14
2005[b]	4.92	0.93	9.34	16.96	24.58	20.26	23.00	
2006[b]	4.56	0.92	8.70	16.57	24.41	20.71	24.12	
2007[b]	4.28	1.44	11.68	19.47	24.86	18.84	19.45	
2008[b]	1.99	0.81	7.15	14.81	24.71	22.46	28.08	
2009[b]	0.47	0.05	1.20	5.63	19.43	25.45	47.76	
2010[b]	0.35	0.01	0.20	1.08	14.45	26.80	57.09	

[a] Most FICO score data are obtained from the previous HUD special data collection project. Problematic loans were over-sampled during the years 1997 to part of 2004.
[b] Starting May 2004, lenders are required to report FICO data directly to HUD.
[c] Mixture of the above two sources of data.

Source: FY2010 Actuarial Review of MMIF, IFE Group.

Losses from sub-prime borrower credit are usually manageable when there is significant equity on the part of the borrower. It is the combination of poor credit history and low/no down-payment that have resulted in tremendous losses, both for FHA and private sub-prime mortgage lending. As the following table (Anderson, Capozza and Van Order) illustrates, as low equity is combined with weak credit defaults sky-rocket. Note that the table is normalized so that a loan with a credit score between 680 and 720 and a LTV between 71 and 80% equals "1". Other figures are either fractions or multiples of this number. The magnitudes are nothing short of shocking. Loans with a FICO below 620 and down-payments of less than 10 percent display default rates 20 times that of the base group.

Credit Score	Loan to Value Ratio	<70%	71-80%	81-90%	91-95%
	<620	1.0	4.8	11	20
	620-679	0.5	2.3	5.3	9.4
	680-720	0.2	1.0	2.3	4.1
	>720	0.1	0.4	0.9	1.6

Source: Charles Anderson, Dennis Capozza and Robert Van Order. **Deconstructing the Subprime Debacle Using New Indices of Underwriting Quality and Economic Conditions: A First Look.**

Such high levels of default are not healthy for the borrower, the lender or the taxpayer (not to mention the economy). We know, with near certainty, that borrower credit quality and equity are the drivers of default, both in FHA and in the mortgage market generally. If we wish to protect the taxpayer and avoid a future bailout of FHA, these are the policy margins along which we must make substantive changes. Given the relatively "safe" features of an FHA loan, we do not have to guess about loan characteristics driving the borrower into default. We know it is equity and credit history that drives losses.

To insure that FHA guarantees loans that are both sustainable on the part of the borrower and also represent a minimum risk to the taxpayer, I urge that the following:

- Immediately require a 5 percent cash down-payment on the part of the borrower.
- Require FHA to allow only reasonable debt-to-income ratios.
- Restrict borrower eligibility to a credit history that is equivalent to no worse than a 600 FICO score.
- Require pre-purchase counseling for borrowers with a credit history that is equivalent to a FICO score between 600 and 680.
- Require a 10 percent down-payment, immediately, for borrowers with a credit history equivalent to below a 680 FICO score.
- Borrower eligibility should also be limited to borrowers whose incomes do not exceed 115 percent of median area income, so as to mirror the requirements of section 502(h)(2), as amended, of the Housing Act of 1949.

Towards a Fairer Sharing of Risk

It is not solely the behavior of the borrower that matters for default. Incentives facing the lender also greatly contribute to default. Where the lender bears the full cost of default, we can expect prudent and careful underwriting to prevail in the long run (as the imprudent eventually fail, unless we rescue them). Where the lender, with little penalty, can pass along the cost of default to another party, for instance the taxpayer, then poor or negligent underwriting is to be expected. Accordingly, we must change lender incentives under the FHA program. As has been repeatedly detailed by HUD's Inspector General, FHA has long shown a lax attitude toward lender fraud and misbehavior. Given the legitimate due process concerns that arise when any party receives a government benefit or participates in a government program, FHA's ability to effectively eliminate fraud *ex post* will always be somewhat limited. Of course this does not eliminate the necessity of doing so. It does imply, however, that alternative means must be found for improving the incentives facing lenders.

In order to provide the appropriate incentives for lenders to conduct sufficient due diligence and quality underwriting, I urge the following:

- Immediately reduce maximum claim coverage from 100% of loan to 80%.
- Require lenders to "take back" any loan that defaults within six months of origination.
- FHA should also end the process of letting the lender choose the appraiser and return to the safeguard of an appraisal board.

Conclusions

The history of FHA has been one of an almost constant reduction in standards, usually as an excuse to "re-start" the housing market. Indeed the first substantial legislation changes were made just four years after its creation, when in 1938 Congress lowered down-payment requirements from 20 to 10 percent and extended the maximum loan duration from 20 years to 25. This did little for the housing market, which did not begin to recover until after World War II.

The recent housing boom and bust has witnessed a similar reaction. Attempts to re-start the bubble by transferring massive amounts of risk to the taxpayer. Again these efforts have accomplished little at great cost. We should not repeat the same mistake that has followed almost every housing bust in the last 100 years. Instead of leaving these additional stimulants in place, we should begin moving federal mortgage policy towards a sounder footing. Only then can we hope to avoid having the taxpayer left holding the bag when the next bubble inevitably bursts.

Future projections of FHA's financial health depend critically upon a significant increase in credit quality. In order to protect the taxpayer, Congress should begin making efforts to guarantee that increase in credit quality today.

Present Value of Future Cash Flows as of the End of FY 2010 By Origination Fiscal Year & Mortgage Type ($ Millions)							
Fiscal Year	FRM 30	FRM 15	ARM	SR 30	SR 15	SR ARM	Total
1981	0						0
1982	0						0
1983	0						0
1984	0						0
1985	0						0
1986	-1		0				-1
1987	-2		0				-2
1988	-2		0				-2
1989	-3		0				-4
1990	-4		0	0			-4
1991	-6		0	0		0	-7
1992	-5		-1	0		0	-6
1993	16		3	-1		0	18
1994	22		4	-2		0	23
1995	8		1	0		0	9
1996	13	0	-2	0	0	0	11
1997	7	0	-5	0	0	0	1
1998	7	0	-5	-4	0	0	-3
1999	-10	-1	-4	-7	0	-1	-23
2000	-97	0	-15	-1	0	-1	-114
2001	-264	-1	-9	-19	0	-2	-296
2002	-481	-3	-57	-51	-1	-15	-606
2003	-956	-6	-75	-285	-5	-31	-1,357
2004	-1,542	-7	-223	-232	-5	-72	-2,081
2005	-748	-17	-261	-140	-4	-48	-1,218
2006	-1,411	-28	-111	-96	-2	-5	-1,654
2007	-2,458	-41	-82	-129	-1	-4	-2,715
2008	-6,813	-128	-250	-515	-7	-40	-7,753
2009	-4,059	-133	-161	-2,096	-20	-178	-6,648
2010[a]	81	-83	-202	-561	-9	-187	-962
Total[b]	-18,709	-449	-1,456	-4,139	-55	-584	-25,392

[a] Based on the volume and composition distribution of the August 2010 HUD forecast.
[b] Number may not add up due to rounding error.

Source: FY2010 Actuarial Review of MMIF, IFE Group.

Distribution of Originations by Original LTV Category (Percentage of FHA-Insured Mortgages by Dollar Volume)						
Books of Business	Unknown LTV	≤ 80%	> 80% ≤ 90%	> 90% ≤ 95%	> 95% < 97%	≥ 97%
1981	26.92	11.88	26.90	18.44	14.72	1.15
1982	16.40	19.17	26.72	22.53	14.34	0.83
1983	20.37	19.06	24.41	21.53	13.38	1.25
1984	2.77	16.19	26.17	26.32	21.52	7.03
1985	1.11	16.19	31.22	27.14	21.69	2.64
1986	0.56	18.26	30.33	27.35	20.51	3.00
1987	0.18	15.57	27.26	29.84	24.02	3.13
1988	0.13	8.01	19.71	35.57	31.87	4.71
1989	8.91	6.78	16.86	33.13	29.89	4.43
1990	11.91	6.14	16.20	32.21	29.13	4.40
1991	1.79	5.59	15.73	29.70	30.07	17.12
1992	1.76	4.38	13.99	28.03	38.26	13.57
1993	0.31	3.64	12.84	25.76	32.72	24.73
1994	0.24	3.46	11.69	24.44	32.78	27.40
1995	0.07	2.74	10.35	24.46	34.32	28.05
1996	0.03	2.83	11.09	25.51	34.72	25.81
1997	0.01	3.25	11.42	26.19	34.67	24.45
1998	0.01	3.55	12.22	26.46	34.86	22.91
1999	0.00	3.17	9.10	13.29	30.59	43.84
2000	0.00	2.34	6.23	6.81	32.54	52.07
2001	0.00	3.26	7.56	6.85	25.33	57.00
2002	0.00	3.88	8.09	6.84	24.23	56.96
2003	0.00	5.47	9.61	7.11	24.18	53.63
2004	0.01	5.56	9.17	7.23	23.66	54.38
2005	0.01	5.80	9.22	6.81	22.66	55.52
2006	0.01	6.81	10.06	13.88	19.91	49.34
2007	0.01	7.34	11.46	20.91	18.04	42.24
2008	0.01	6.17	12.05	24.04	13.41	44.31
2009	0.01	5.35	14.10	19.62	40.40	20.52
2010[a]	0.01	5.07	15.33	11.48	63.65	4.46

Source: FHA data warehouse, June 30, 2010 extract

[a] Based on partial year data.

Source: FY2010 Actuarial Review of MMIF, IFE Group.

Statement of Peter Carey
President and CEO, Self-Help Enterprises
Board Member, Housing Assistance Council
Board Member, National Rural Housing Coalition
before the Committee on Financial Services,
Subcommittee on Insurance, Housing,
and Community Opportunity
U.S. House of Representatives
May 25, 2011

Thank you for this opportunity to testify about the proposed FHA-Rural Regulatory Improvement Act of 2011. I am Peter N. Carey, President and CEO of Self-Help Enterprises (SHE). I have worked in rural housing for almost 40 years and have directed SHE since 1990. I have extensive experience using both USDA and HUD programs to produce single-family and multifamily housing for low-income rural residents. I serve on the boards of directors of the Housing Assistance Council (HAC) and the National Rural Housing Coalition (NRHC). This testimony is delivered on behalf of all three organizations.

SHE, HAC, and NRHC are among the foremost local and national rural housing organizations in the country. Self-Help Enterprises is a regional nonprofit housing and community development organization serving eight counties in California's agricultural San Joaquin Valley, where about one-quarter of the nation's farmworkers live. The Housing Assistance Council provides financing, information, and technical services to nonprofit, for-profit, public, and other providers of rural housing around the country. The National Rural Housing Coalition is a national membership organization that conducts research, policy analysis, and advocacy on federal rural housing programs.

The draft bill before the Subcommittee would move the housing programs of the U.S. Department of Agriculture's Rural Housing Service (RHS) to the Department of Housing and Urban Development (HUD). Such a move would not improve administration of the rural housing programs, would not help accomplish the mission Congress established them to deliver, and would make it more difficult for USDA to deliver its other rural development programs effectively.

USDA Rural Development and the Rural Housing Service are certainly not perfect. For example, some agency processes could be streamlined and coordination with other funding sources could be improved. RHS has taken steps to strengthen its partnerships with nonprofit rural housing providers, but could do more. USDA's attention to housing issues could be increased. Moving the rural housing programs from one department to another, however, would not address these issues and would create significant additional challenges for the improvement of rural housing conditions.

RURAL HOUSING SERVICE ACHIEVEMENTS

Congress created RHS's predecessor, the Farmers Home Administration, in the Housing Act of 1949 to help fulfill the Act's promise of "a decent home and a suitable living environment for every American family." The programs created by Title V of that Act, or added to it later, are available to low- and very low-income residents of rural areas, defined roughly as places with populations under 20,000. Most of these programs' aid goes to people in places under 10,000 population.

Direct Homeownership Loans

The agency's flagship program, the Section 502 direct loan program, enables low- and very low-income rural residents to purchase homes with affordable, fixed rate mortgages. The interest rate on a Section 502 loan can be as low as 1 percent, and no down payment is required. Inability to qualify for market-rate credit elsewhere is a precondition for obtaining a Section 502 direct loan – thus the program's borrowers are homebuyers who might have resorted to unsustainable predatory loans if Section 502 loans were not available.

Over two million families have become homeowners since 1950 through the Section 502 direct program. In 2009, the average income of Section 502 direct loan borrowers was about $26,600. Sixty percent of the borrowers in 2009 and 2010 had incomes at 60 percent of area median or less, and 40 percent had very low incomes (50 percent of area median or less). Yet this is a loan program, not a giveaway; the funds are repaid to USDA, with interest. The foreclosure rate for Section 502 direct loans is only 4 percent, better than the rate for conventional mortgages or Federal Housing Administration (FHA) loans.

In 2010, RHS made about 10,000 Section 502 loans. The total cost per loan to the government for a Section 502 loan is an impressively low $5,000 (this figure does not include salaries and expenses for USDA employees).

Self-Help Housing

Significant homeownership opportunities are offered through the Section 523 mutual self-help program. Currently, more than 100 organizations across America participate. Groups of eight to 12 families work together to construct their own and their neighbors' homes, providing 65 percent of the construction labor and working hundreds of hours on evenings and weekends. Their work enables them to move in with substantial "sweat equity." Most self-help participants obtain low-cost mortgages through the Section 502 direct loan program.

Self-help families have the lowest rates of default and delinquency among Section 502 borrowers. Over the last three years, self-help housing organizations have constructed about 3,500 homes. This construction has supported over 11,000 jobs and contributed more than $738 million in local income and $77 million in taxes and revenue in rural communities across the country.

Guaranteed Homeownership Loans

Adding to the successes of the Section 502 direct loan program is the Section 502 guaranteed loan program, through which USDA guarantees loans made by banks at market interest rates. The guarantee program assists homebuyers whose incomes are somewhat higher than those who use the Section 502 direct program – $46,700 in 2009 – but not high enough to qualify them for standard mortgages.

Rental Housing

USDA finances rental housing as well. The Section 515 program has made loans directly to nonprofits, for-profits, and partnerships to develop more than half a million units of rental housing for low- and very low-income tenants. As of April 2010 the average annual income of Section 515 tenants was $11,000. More than half of these tenants are elderly or disabled.

The Section 514/516 program provides loans and grants to developers of rental housing for farmworkers, whose incomes are not only low but are also often irregular. RD has funded more than 38,000 farmworker rental housing units. These decent, affordable homes, available to both migrant workers and non-migrants so long as they are U.S. citizens or are working legally in this country, are a significant improvement over the crowded or ramshackle buildings that may be available otherwise, or the tents and cars that still provide shelter for many migrant farmworkers.

Other Programs

In addition to these major programs, USDA's rural housing arsenal includes loans and grants for low- and very low-income homeowners whose homes need repairs to meet basic safety codes, rental assistance for tenants in USDA-financed properties, aid to owners of rental properties that need repairs or renovations, and more.

Field Offices

This variety of assistance is offered through field offices designed to be accessible to rural Americans. USDA's Rural Development mission area has 47 state offices and 560 field offices serving all 50 states and the U.S. territories. Until the early 1990s the Farmers Home Administration had offices in almost every one of the 2,000 rural counties in the country. Congress, through the Department of Agriculture Reorganization Act of 1994, required restructuring of USDA's rural housing and community development functions and consolidation of some locations and employees. Field staff now offer housing, utilities, and business programs from a more efficient, yet still localized, network of offices.

Through its field offices, RHS understands communities that traditional lenders never see. Agency staff share their communities' development goals. For example, over the last two decades in California we have seen a remarkable partnership between RD, nonprofits, and for-profits. All entities have been dedicated to improving housing in rural communities with persistent needs.

HUD EXPERIENCE WITH RURAL ISSUES

While there are concerns about USDA's attention to housing, we have equally grave concerns that HUD's structure is not set up to administer the Title V programs.

HUD has limited experience administering programs that are directed exclusively to rural areas. The Rural Housing and Economic Development program began in 1999 and received $20-$25 million per year until it was terminated at the end of fiscal year 2009. In 2010 a new Rural Innovation Fund program was created, but it did not receive funding in FY 2011. The Housing

Assistance Council is a rural program at HUD, with HAC serving as an intermediary that helps HUD staff deliver aid to rural communities.

Most of HUD's other programs can be used in rural areas as well as in larger towns and cities. The design of most HUD programs, however, as well as the department's office structure, are urban-oriented. Large programs like HOME and the State Administered Community Development Block Grant are intended to reach rural areas through state government agencies. Yet historically HOME, CDBG, and FHA have spent lower proportions of their funds in rural areas than the proportion of population living there.

HUD has never had a direct homeownership lending program like Section 502, and has not made direct loans to developers, as USDA does under the Section 515 program, since 1973. HUD's experience is in delivering block grants, guarantees and rental subsidies, not mortgage loans. It works through others: local governments, state and tribal governments, developers, banks, intermediary organizations, and public housing authorities. In short, while the loans and grants offered by many of the Title V programs are retail items, HUD is a wholesaler, not a retailer.

Because its program delivery has not required a network of field offices outside major metropolitan areas, HUD does not have the office infrastructure needed for the Title V programs. In my state of California, HUD has six field offices, located in Fresno, Los Angeles, Sacramento, San Diego, San Francisco, and Santa Ana. USDA Rural Development has a state office in Davis and 18 local offices. I can drive less than 10 minutes from my office in Visalia to reach the local USDA RD office, but staff in HUD's Fresno office do not handle program funding, so to meet with HUD staff I must travel 250 miles to either San Francisco or Los Angeles.

The difference is even more dramatic in states with fewer large urban centers. In Illinois, for example, HUD has offices in Chicago and Springfield, while Rural Development has a state office in Champaign, 12 field offices, and two work stations. In West Virginia, HUD has an office in Charleston. Rural Development has a state office in Morgantown, four area offices, and seven sub-area and satellite offices.

The dollar amount involved would not provide a significant incentive for HUD to increase its capacity to deliver rural programs. The entire RHS budget, including salaries and expenses, is about $2 billion. It comprises around 10 percent of USDA's entire budget of about $20 billion, but would be less than 5 percent of HUD's $42 billion budget.

IMPACTS OF TRANSFERRING RURAL HOUSING PROGRAMS

Interaction with Other USDA Programs

Housing improvement is inextricably intertwined with the other community improvement efforts administered by USDA's Rural Development mission area: rural community facilities, rural businesses and cooperatives, and rural utilities. RD's programs address all these facets of rural development efforts, and RD's staff understand the relationships among them. Decent, affordable housing relies on the presence of good water and wastewater systems, and business development relies on the presence of decent, affordable housing for workers. Removing the rural housing programs from USDA would create a silo effect that would damage efforts to improve local economies in rural communities.

Office Delivery System

Accommodating the retail nature of the Title V programs would require HUD to shift dramatically the way it does business. Given the many demands on federal spending at this time, it seems more likely that the rural housing programs would be forced to fit into the HUD delivery system, eliminating the programmatic and operational features of RHS that are essential for the Title V programs to meet their mission.

The low-income rural residents served by the Title V programs cannot be expected to travel to major urban centers to learn about and apply for housing assistance. Repeatedly finding transportation and taking time off work are daunting for low-income people even in cities, and more so in rural places, especially in remote areas or in those with cultural differences such as American Indian lands and farmworker communities. Few rural residents can apply online, since they often lack computers or fast and reliable internet access, and even if community centers or libraries have internet availability, those places are often many miles away. Telephone access is usually not enough; it is very difficult to provide explanations and take applications by phone. Realistically, then, local offices staffed by local residents with knowledge of local habits and culture are the only way to reach the people for whom the Title V programs are intended.

Management of the multifamily rural housing portfolio also relies on the field office network. RD field staff are familiar with local market conditions, a critical advantage in underwriting and determining the feasibility of new construction or rehabilitation proposals. Field staff often have long-term knowledge of each project in the portfolio and become aware of operational, financial, or physical condition issues more quickly than if they were in a central location. Typically, RD projects are small – less than 30 units – and located in spread-out rural areas, making it expensive to hire contractors for asset management services.

Since RD projects are so small, the project owners are often "mom and pop" entities that require more "hands-on" supervision by the government. Larger projects are more often developed, and managed, by sophisticated entities that may be more familiar with agency requirements. Again, RD's field structure is beneficial in that it facilitates the use of "hands-on," localized project oversight.

Finally, removing housing functions from Rural Development field offices would not eliminate the need for those offices. Staff would still be administering USDA Rural Development's utilities and business programs, and many local RD offices are co-located with offices of other USDA divisions such as the Farm Service Agency. These offices provide a range of services to rural communities and are the only places that a family, a home builder, a small town mayor, and a farmer can go to get assistance and advice from the federal government.

Time, Expense, and Priorities

While Congress and the taxpayers are concerned about the recent increase in federal domestic spending, rural housing and community development programs have not seen an increase. Indeed, with the exception of added amounts under the American Recovery and Revitalization Act, their appropriations have been declining for several years. In FY 2003, spending on rural housing loan programs totaled $342 million. In FY 11 it is $150.3 million. If Congress freezes the rural housing loan programs for FY 12, their budget authority will still be less than half the amount in FY 2003.

Moving a $2 billion agency from one department to another is a significant task that would be expensive and would take time to accomplish. Rural Americans, like our urban and suburban neighbors, face great economic challenges. The poverty rate in California's San Joaquin Valley, part of the richest agricultural area in the world, is about 20 percent. Some other rural areas suffer even higher poverty rates. Throughout rural areas there is meager economic growth and a crying need for affordable housing, clean water, and economic opportunity. Over the last two decades, appropriations for rural development have plunged. The taxpayers' money and the government's time would be far better spent making smaller changes to improve the programs within USDA, rather than creating new challenges that must be met before program function can be addressed.

The cost in money and human capital to make such a move would be mind-boggling. Over 600 people and the attached infrastructure would have to be moved. Staff who are familiar with HUD programs and delivery systems would require significant training to understand the characteristics of rural housing programs such as the large vacancy rate changes in housing for seasonal farmworkers. Inevitably, over the 18 or more months likely to be needed for such a move, service delivery would be disrupted for American families who are already struggling.

There is no doubt that RHS can and should do better. There is also no doubt that HUD lacks the administrative system to deliver rural housing programs. Its programs, constituency, and interests lie elsewhere. Self-Help Enterprises, the Housing Assistance Council, the National Rural Housing Coalition, and hundreds of other rural housing organizations around the country would be happy to work with this Subcommittee to identify less expensive, more effective ways to address RHS's shortcomings and maximize its abilities.

We have no objection to the provisions of Section 14 of the draft, which would authorize fees for the Section 538 rental housing guarantee program, making the program self-supporting.

Thank you for the opportunity to testify before you today. Please do not hesitate to call on me for further information.

Written Testimony of Brian Chappelle
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Washington D.C.

Hearing before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
on
"Future Role of FHA, RHS and GNMA in the Single and Multifamily Mortgage Markets"

Wednesday, May 25, 2011

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify on the future role of the FHA program. I am Brian Chappelle of Potomac Partners LLC, a Washington–based consulting firm specializing in mortgage finance.

In my testimony, I would like to address the following areas:

- The mortgage market today and FHA's role
- The effectiveness and current financial condition of FHA & Ginnie Mae
- Reforms proposed in the Discussion Draft
- Other legislative and regulatory suggestions to improve the program

I. Mortgage Market Today and FHA's Role

The state of the housing market is described in the minutes of the latest Federal Reserve's Federal Open Market Committee (FOMC) meeting of April 26-27, 2011 as follows: "activity in the housing market remained very weak" and "demand for housing ... continued to be depressed" even though the economic "recovery was continuing at a moderate pace".

In his semiannual monetary policy testimony earlier this year, Federal Reserve Board Chairman Bernanke noted "many potential homebuyers are still finding mortgages difficult to obtain".

Recent FHA, Fannie Mae and Freddie Mac purchase activity confirm the Federal Reserve's observations. In 2010, the three agencies financed less than 2 million purchase loans. That is 9% fewer than they collectively backed in 2009 and more than 30% below the pre-bubble year of 2000. And it appears to be getting worse --- FHA purchase volume has declined 33% in the first seven months of FY 2011.

The good news is that the borrowers being approved today have the highest credit quality in many decades, as the remarkably low early-default rates demonstrate. You can reasonably conclude that the fundamental housing problem today does not stem from the approval of homebuyers with poor credit characteristics, but rather, from the inability of many credit worthy borrowers to obtain mortgages, thereby discouraging potential homebuyers and putting downward pressure on house prices.

As the Subcommittee considers these complex issues, the immediate concern is not about which sector of the market (private or public) is supporting the housing market, but that combined, the public and private sectors are originating a totally inadequate number of purchase mortgages.

Moreover, FHA has already taken significant steps to facilitate the recovery of the private sector by raising its insurance premiums four times in the last three years. The premium is now about 60% higher than it was in May 2008. The increased premium, coupled with the improved performance of the FHA portfolio, should enable FHA to reach the all-important 2% capital ratio much sooner than the auditors projected in the FY 2010 actuarial review.

II. Current Effectiveness and Financial Condition of FHA & Ginnie Mae

Current Effectiveness of the FHA Program

Over the years, two principal objectives have evolved for the FHA single Family program. They are: 1) to serve homebuyers who are not adequately served by the private sector and 2) to operate at no expense to the American taxpayer.

A. FHA's Mission

After the collapse of the housing market in mid-2007, the FHA stepped-in and, to the surprise of some, performed its historic role of counter-cyclicality in a manner that would have made its founders proud. FHA was, in effect, the last entity standing and became the primary financing source for home purchasers. While FHA has helped millions of families from all walks of life to finance their home purchases and refinances, it has continued to fulfill its social purpose according to the Federal Reserve's study on the 2009 data submitted pursuant to the Home Mortgage Disclosure Act (HMDA). The Federal Reserve found that:

- 65% of low and moderate income homebuyers obtained government loans; only 15% chose government loans in 2006. (75-80% of government loans are FHA)
- 48% of homebuyers in distressed areas obtained government loans; only 6% did in 2006.
- Approximately 75% of African American/ Hispanic homebuyers obtained government loans in 2009; only about 20% did in 2006.

FHA's own data for 2010 and 2011 continues to support the Fed's analysis. Approximately 75% of FHA purchase mortgages were for first-time homebuyers and about 30% of FHA purchase loans were for minority homebuyers.

B. FHA's Financial Responsibility

The second principle, which has become even more critical because of the government's challenging fiscal environment, cannot be compromised: FHA must operate at no expense to the American taxpayer as it has for its entire history. Like any successful insurance program, the homebuyers who benefit from the program (in effect policyholders) pay the premiums to cover the costs of insurance. FHA's founders realized this when they charged a high insurance premium (1% annual premium) to ensure that FHA was well-capitalized just like FHA management does today.

(It should be noted that the annual premium was lowered to .5% in 1939 and stayed at that level until 1983 when the Congress enacted the upfront premium of 3.8%, which was the equivalent of the .5% annual premium. In 1990, Congress enacted reform legislation that permitted HUD to charge both an upfront and annual premium. The program also had a mutuality feature until about 20 years ago, which provided distributive share payments (or refunds) to FHA borrowers if their book of loans performed well.)

FHA & Ginnie Mae's Current Financial Condition

Analysis of FHA's and Ginnie Mae's financial performance includes a review of their operational structure and core responsibilities. Ginnie Mae is discussed separately at the end of this section.

FHA's Operational Structure & Responsibilities

In evaluating FHA's financial condition, it is first appropriate to review FHA's operational process since, in 2007, many were also doubting FHA's ability to process the impending flood of loan activity in addition to being concerned about the potential costs to the taxpayer.

There are two principal reasons for FHA's success in handling the spike in the volume without any serious processing delays and at no expense to the taxpayer. First, in 1983, FHA delegated all processing and underwriting functions to approved lenders. Under this program, called Direct Endorsement, FHA authorized approved lenders to originate and close loans without prior HUD review. FHA's functions are concentrated on loan review, oversight and enforcement. With the Subcommittee's support, FHA has improved the tools to carry out these duties.

While it is discussed in greater detail at the end of this section, FHA lenders have significant motivation to operate in a responsible manner in the FHA program. Probably the best example is that, even though an FHA loan is 100% government guaranteed, FHA lenders, starting in early 2008, began imposing their own underwriting restrictions (called credit overlays) on top of FHA underwriting requirements. These overlays have certainly contributed to the over-all quality of the FHA portfolio.

Much has been made of FHA's "antiquated" technology and the need for a complete overhaul of HUD's systems. While some of FHA's systems are old, they are reliable and robust. Even though FHA activity has quintupled from early 2007, our firm is unaware of serious glitches of any kind in the single-family processing system (called FHA Connection) and we interact with FHA lenders on a daily basis.

Taken together, the delegation of processing and underwriting to approved lenders and a reliable automated system enabled FHA to support the housing market immediately after the collapse of the mortgage market.

FHA's Current Financial Condition

In analyzing FHA's financial health, there are four key components that should be considered. They are:

1. FHA's actuarial status: The actuarial review reflects the independent auditor's projection of FHA's ability to pay claims over the entire life of the portfolio (30 years).
2. FHA's cash flow position: FHA's ability to pay claims over the next several years.
3. FHA's credit characteristics: Credit characteristics (particularly credit scores) of the portfolio and new originations, in particular, are important indicators of future performance.
4. FHA's loan performance: The serious delinquency rates of the portfolio and recent originations are critical measures of the program's current operations.

FHA's performance improved in 2010 and has continued to improve in 2011. Just last week, MBA's National Delinquency Survey reported that FHA was the only product type to see its total delinquency rate fall in the 2011 1st Quarter and, in fact, FHA's total delinquency rate is now at the lowest level in more than 5 years.

FHA's net worth is growing faster than expected

At an April 7th Senate Appropriations hearing on the Federal Housing Administration Secretary Donovan said:

> "We expect FHA to make substantially more money for the taxpayer this year than our actuary predicted"

Since FHA's independent actuary projected that FHA's FY 2011 economic value (after paying all expected claims and expenses) would be $10.9 billion, this means FHA's net worth is expected to double in FY 2011. The Secretary added, "Early payment defaults have declined substantially" and FHA has "substantially improved the quality of loans that we are making."

The Secretary did point out that FHA still faces risk from factors beyond its control, namely the impact of additional declines in house prices. He also noted that FHA and its independent auditors have used conservative house price forecasts in their analysis.

The latest public data on the key performance criteria for FHA's basic single-family ("forward mortgage") program are compiled below. (The Home Equity Conversion Mortgage (HECM) program is excluded.) The highlights are:

- FHA's economic value (net worth) and capital ratio are increasing
    - Secretary Donovan said FHA's economic value is on pace to exceed the auditors' projection for FY 2011, which is $10.9 billion (almost $13 billion if the $1.75 billion transfer to HECM account is included).
    - FHA's capital ratio increased from .42 percent to .79 percent in FY 2010 and should be over 1% (1.25% including HECM transfer) in the FY 2011 audit (assuming the house price forecast remains the same).
- FHA's cash reserves to pay claims is growing
    - Even in a Depression scenario, FHA's auditors believe that FHA would have almost $10 billion in cash reserves remaining after paying all claims.
- FHA's serious delinquency rate for its portfolio is declining
    - Through March 2011, the serious delinquency rate has declined to 8.3%. It was 9.1% in March 2010.
    - "This improved loan performance is due to the stronger 2009-2011 books". (HUD Quarterly Report to Congress on MMI Fund (FY2011 Q1))
- FHA's recent originations (loans originated in 2009 & 2010) now have historically low rates of serious delinquency. (HUD Quarterly Report)
    - The early period delinquency rate has fallen 85% since 2007. (Early period delinquency includes loans that experienced a 90-day delinquency within the first six required payments.

- FHA's current credit quality is the "highest quality on record"
    - Credit scores above 680 account for 60% of FY 2011 originations; 19% for 2007 originations
    - Credit scores below 620 account for 3% of FY 2011 originations; 45% for 2007 originations (HUD Quarterly Report)

Below are expanded details on FHA's financial and loan performance. (All data obtained from FHA publications.)

The key points are:

- **FHA's finances continue to improve**
    - FHA's economic value is growing faster than expected
        - Secretary Donovan said FHA's FY 2011 economic value (net worth) is on pace to exceed the auditors' projection of $10.9 billion, which would be almost $13 billion if the $1.7 billion payment to bolster the HECM program was included.
        - FHA's FY 2010 independent auditor determined that the economic value (capital) of the fund nearly doubled from $2.9 billion in FY 2009 to $5.16 billion in FY 2010 (FHA's FY 2010 capital would have been over $7 billion if the HECM payment was included).
            - Seller funded downpayment assistance (SFDPA) loans are expected to have a "net cost of $13.6 billion" according to the auditors.
            - The fund would be above the 2% capital ratio today if SFDPA loans are excluded.
        - In addition, while FHA's foreclosure inventory is at 176,000 properties ("an historic high"), these loans and costs are fully accounted for in FHA's actuarial review (and economic value).
        - FY 2011 book is now projected to perform even better
            - In his April 7th testimony, Secretary Donovan also testified that the FY 2011 book (by itself) is projected to generate almost $10 billion in net income; <u>$4 billion more than was anticipated</u>.
        - What economic value means:
            - After paying all anticipated claims and administrative expenses over the next 30 years, the auditors projected that, as of the end of FY 2010, the FHA single family "forward" program will not require any additional funds

and will provide the U.S. Treasury over $7 billion in "profit" (projected to be almost $13 billion in the FY 2011 audit excluding the HECM program).

- FHA's all-important capital ratio is also increasing
  - FHA's capital ratio (for single-family forward portfolio) increased from .42 percent to .79 percent in FY 2010 and should be over 1% (1.25% if HECM transfer is included) in the FY 2011 audit (assuming the house price forecast remains the same).
  - Secretary Donovan indicated that FHA should reach the 2% level sooner than FY 2015.

- The new credit subsidy rate for FY 2011 originations has improved to – 2.58 %. (HUD Quarterly Report to Congress)
  - The credit subsidy rate was -1.13% for originations in the second half of FY 2010.
    - In the federal budget, a negative rate means, "the present value of premium revenues is expected to be greater than the present value of net claim expenses".
  - FHA is "now putting more money in its capital reserve account" because of better loan characteristics and higher premiums (2.58% of every dollar insured)

- FHA capital reserves (cash & Treasury securities) are also increasing
  - At the end of FY 2010, FHA's capital reserves increased to over $33 billion on hand.
    - In his April 7th testimony, Secretary Donovan said: "total reserves ... were at an historical high of more than $31 billion" in FY 2009 and "grew again" in FY 2010.
  - Even in a Depression scenario, FHA would have almost $10 billion remaining after paying all claims.
  - "FHA's core insurance operations outperformed last year's actuarial projections (FY 2009) by $5.5 billion." (Financial Status of the FHA Mutual Mortgage Insurance Fund)
  - FHA's new premium structure (lowering upfront premium and increasing annual premium) is expected to provide more total revenue over the life of the loan. However, it does create a temporary cash flow imbalance, but it should not last more than a year. (HUD's Quarterly Report to Congress).

  - After a slight decline in FY 2011 (as a result of the MIP change), FHA's cash reserves are expected to grow to $42 billion over the next five years.

- **FHA's portfolio serious delinquency rate is improving**

  In addition to the positive results in MBA's latest National Delinquency Survey, below is the latest FHA data on the performance of the portfolio.

  - The serious delinquency rate (90+ days delinquent, cases in foreclosure, etc.) declined from 9.44% in December 2009 to 8.78% in December 2010.
    - 2007 & 2008 books, which are the worst performing, "now represent just 15% of the active portfolio, compared to close to 19% one year ago"
  - The serious delinquency rate has continued to decline in 2011.
    - Through March 2011, the serious delinquency rate had declined to 8.3%. It was 9.1% in March 2010.
  - As FHA seller funded downpayment assistance loans (SFDPA) work themselves out of the portfolio, performance should improve further.
    - SFDPA share of portfolio was 17% in FY 2010 and should fall below 15% in FY 2011.

- **FHA's recent originations (2009 & 2010) are performing extremely well.**

  - As the Secretary said, "early payment defaults have improved substantially"
  - Only 13% of FHA's seriously delinquent loans are now less than two years old. In December 2009, 30% of seriously delinquent loans were less than two years old. (Neighborhood Watch & FHA Outlook Reports)
  - HUD's Quarterly Report to Congress states:
    - "Early indications are that the FY 2010 book should perform substantially better than the FY 2009 book, which itself performed substantially better than the FY 2007 and 2008 books."
    - "The quality of newly originated FHA loans continues to improve each quarter, ... with the early-period delinquency rates of new loans falling to a historic low of .37 percent".

  Below is a chart of FHA's early period delinquency rates (serious delinquency "within first six required mortgage payments") for 2007 - 2010. (The second quarter of each year was chosen to exemplify the improvement because April-June 2010 is the latest quarter available and the rate has declined for every quarter since April-June 2007.)

Early Period Delinquency Rate
All FHA Loans

	Origination Quarter	Early Period Delinquency Rate
o	2007 (April – June)	2.54%
o	2008 (April – June)	2.08%
o	2009 (April – June)	1.01%
o	2010 (April – June)	.37%

The early period delinquency rate has fallen 85% from 2007 to 2010.

- FHA's Neighborhood Watch database provides more insight on the number of performing and seriously delinquent loans.
  - The seriously delinquent rate for loans originated in the last two years fell from 5.05% in December 2009 to 2.83% in December 2010. The December 2010 rate is the lowest level in more than 5 years.
  - The seriously delinquent numbers have continued to improve in 2011. The seriously delinquent rate has fallen to 2.26% in March 2011, which is approaching the lowest rates ever for loans originated in any two-year period since Neighborhood Watch was implemented in 1999.
  - The data for the two-year period ending April 30, 2011 was just published and the seriously delinquent rate has fallen to 2.1%, which appears to be the lowest rate in the 12 years that Neighborhood Watch has been operating.
- Below is a chart from FHA's Neighborhood Watch database that compares seriously delinquent rates for originations for two-year periods by quarter since 2008.

- All Lenders/Areas - Area Totals
  United States Totals
- Delinquent Choice - Seriously Delinquent
  Performance Period - All Quarter End Dates
  Loan Portfolio: 2 Year FHA
- Sort Order by Quarter End Dates in Descending Order
- Data shown includes all quarter end dates of insured single family loans for the two year period by beginning amortization date

Rank	Area	Quarter End Date	Total Orig.	Total Seriously Delinquent	Total Claims	Total Seriously Delinquent and Claims	% Seriously Delinquent and Claims
1	United States	03/31/2011	3,311,056	70,206	4,714	74,920	2.26
2	United States	12/31/2010	3,430,615	90,936	6,017	96,953	2.83
3	United States	09/30/2010	3,442,543	103,198	7,753	110,951	3.22
4	United States	06/30/2010	3,446,807	117,934	8,206	126,140	3.66
5	United States	03/31/2010	3,399,995	142,832	8,978	151,810	4.47
6	United States	12/31/2009	3,212,363	154,190	7,959	162,149	5.05
7	United States	09/30/2009	2,878,599	134,910	7,219	142,129	4.94
8	United States	06/30/2009	2,483,073	105,969	6,144	112,113	4.52
9	United States	03/31/2009	2,105,924	88,002	5,244	93,246	4.43
10	United States	12/31/2008	1,788,355	72,809	4,210	77,019	4.31
11	United States	09/30/2008	1,477,687	50,088	3,508	53,596	3.63
12	United States	06/30/2008	1,179,175	37,667	3,332	40,999	3.48
13	United States	03/31/2008	977,809	33,712	3,344	37,056	3.79

As the chart demonstrates, FHA's seriously delinquent rate deteriorated in late 2008 and 2009 even though total originations more than tripled. In Neighborhood Watch, when volume increases, performance should improve because new loans lack seasoning and are less likely to be seriously delinquent. Consequently, it was troubling that the seriously delinquent rate increased rapidly in 2009. It documents the poor performance of the 2007 and 2008 originations (particularly single family downpayment assistance loans).

Conversely, it is very encouraging that the serious delinquency rate has fallen precipitously in 2010 even though the origination volume leveled off and has started to decline. Some noteworthy points are:

- The number of seriously delinquent loans for loans originated in the respective two-year periods has fallen 54% (from 162,149 serious delinquencies in December 2009 to 74,920 loans in March 2011).
- In April, the number of seriously delinquent loans fell almost another 10% to 67,843 seriously delinquent loans.

- There are fewer recent originations in serious delinquency in March 2011 than were seriously delinquent in December 2008 even though there were over 1.5 million more FHA loans originated in the two-year period ending in March 2011.

- **FHA loans originated in 2010 are performing even better than loans originated in 2009.**
  - The seriously delinquent rate for loans originated in a one-year period fell from 1.23% in December 2009 to .43% in December 2010.
  - The one year performance numbers have continued to improve in 2011 as the seriously delinquent rate has declined to .38% for loans originated in the last year as of March 2011.

Below is a chart from FHA's Neighborhood Watch database that compares seriously delinquent rates for loans originated in the last year by quarter. (This feature was added to Neighborhood Watch in December 2009.)

All Lenders/Areas - Area Totals
United States Totals
Delinquent Choice - Seriously Delinquent
Performance Period - All Quarter End Dates
Loan Portfolio: 1 Year FHA
Sort Order by Quarter End Dates in Descending Order
Data shown includes all quarter end dates of insured single family loans for the one year period by beginning amortization date

Rank	Area	Quarter End Date	Total Orig.	Total Seriously Delinquent	Total Claims	Total Seriously Delinquent and Claims	% Seriously Delinquent and Claims
1	United States	03/31/2011	1,418,406	5,330	28	5,358	0.38
2	United States	12/31/2010	1,461,466	6,728	30	6,758	0.46
3	United States	09/30/2010	1,611,737	9,582	92	9,674	0.60
4	United States	06/30/2010	1,736,895	11,429	69	11,498	0.66
5	United States	03/31/2010	1,869,818	17,433	143	17,576	0.94
6	United States	12/31/2009	1,878,768	23,577	140	23,717	1.26

Like the two-year view described earlier, Neighborhood Watch's one-year view has improved steadily in 2010.

- The number of seriously delinquent loans for loans originated in the respective one-year period has fallen 77% (from 23,717 loans in December 2009 to 5,358 loans in March 2011).
- In April 2011, serious delinquencies fell to 5,097 loans.

    - Since only 5,097 seriously delinquent loans (out of 1.4 million total loans) were originated in the last 12 months, it demonstrates that possible fraud or underwriting errors are also declining since those problems typically surface shortly after origination.

- **FHA has benefited both from insuring more higher quality loans and fewer loans with credit scores below 620 since 2008. (HUD Quarterly Report to Congress)**

    - FHA loans with credit scores above 680 have increased from 20% of FHA's originations in 2007 to almost 60% of FHA's originations in 2010.
    - FHA loans with credit scores over 720 now comprise 37% of FHA's originations. In 2007, they were about 10% of FHA's originations.

    - Why is this important?
        - FHA loans with credit scores above 680 and minimum downpayments perform better than loans with credit scores below 680 and 10% downpayments.

    - FHA loans with credit scores below 620 have declined from about 45% of FHA's business in 2007 to 4% in 2010.

    - Why is this important?
        - FHA loans with credit scores below 620 are the primary source of FHA claims because these borrowers are the most vulnerable to economic downturns.

While the FHA program has certainly not been immune to the impact of widespread house price depreciation, FHA is actuarially sound and is getting stronger. FHA's performance improved in FY 2010 and has continued to improve in FY 2011 in each of the four key financial barometers.

Source for this data: All data obtained from FHA reports on HUD's website @ http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgrroom and FHA's Neighborhood Watch database @ https://entp.hud.gov/sfnw/public/

The reports are: 1) Quarterly Report to Congress on the Financial Status of the MMI Fund, 2) Actuarial Reviews, 3) FY 2010 Report to the Congress on the Financial Status of the MMI Fund, 4) FHA Outlook Reports, and 5) Monthly Reports to the FHA Commissioner.

Reasons for FHA's Excellent Performance

Of the reasons for the FHA's excellent performance, some are more obvious than others. FHA has certainly benefited from the leadership of the Secretary and his team at FHA (former Commissioner David Stevens, Acting Commissioner Robert Ryan and Deputy Assistant Secretary for Single Family Housing Vicki Bott). They have shored up FHA's balance sheet and strengthened risk management.

FHA Requires Verification of Income and Assets

Part of FHA's success is also attributable to the fact that it never insured new loans that did not require verification and documentation of borrower's income and assets. In addition, like any successful insurance company, it has considerable actuarial experience in pricing loans, adjusting premiums up and down as market conditions merit. As noted earlier, FHA has raised premiums four times in the last three years.

Lender Imposition of Credit Overlays

Several factors not readily apparent about the FHA program combine as effective checks and balances on lender actions. The impact is exemplified by the fact that lenders put their own underwriting restrictions (called credit overlays) on top of government restrictions. With credit overlays, lenders in effect are saying they are unwilling to originate certain loans that meet government underwriting criteria.

In late 2007, there was widespread concern that the FHA would become the "dumping ground" for subprime loans and, in fact, FHA did experience deterioration in credit quality at that time. The experiences of three top 10 lenders document this problem. One top 10 lender's average FHA FICO score dropped from 634 to 614 in the third quarter of 2007 compared with 2006. Another's average FICO score fell to 586 in November 2007. At a third, 22% of borrowers in November 2007 applications had FICO scores below 560. In response to this deterioration, mortgage lenders on their own, particularly the large purchasers of FHA loans, tightened underwriting guidelines (e.g. established credit score floors of 620 to 640).

Starting in early 2008, FHA's credit quality began to improve steadily. In the fourth quarter of 2007, 47% of FHA borrowers had credit scores below 620. In virtually every quarter since then, the percentage of loans to borrowers with credit scores below 620 has fallen and is now about 3% of FHA loans (excluding streamline refinances). In actual number of loans, the change is equally significant. In 2007, FHA insured about 150,000 loans with credit scores below 620. In 2010, FHA insured less than 50,000 loans with credit scores below 620 even though FHA activity was approximately four or five times FY 2007 levels.

Why do lenders put credit overlays on loans with 100% government insurance?

Though it may surprise some, the FHA already has its versions of risk retention ("skin in the game") and transparency. First, unlike alternative-A and subprime products, in which the risk was mispriced and the value of the loan was in its "origination" and sale in the secondary market, the ultimate economic value of an FHA loan is in the monthly servicing fee (an annuity-like payment) on a performing loan. In short, long-term loan performance matters in the FHA program.

Since the primary economic value of an FHA loan is the monthly income collected by the servicer, not origination fees, the FHA program, in effect, has a performance-based compensation system. This "deferred compensation," coupled with the consolidation of FHA servicing (five lenders service more than 70% of FHA loans), means that a small group of large financial institutions will have invested an estimated $4 billion this year to buy FHA originations from smaller lenders and mortgage brokers. To protect their investments, these servicers have incentive to monitor originator performance.

And since FHA cannot rely on business self-interest alone to ensure that all lenders act responsibly, it has also developed enforcement tools, including indemnifications (FHA's "repurchases") and, arguably even more important, the public announcement of any FHA sanction. For large public companies, a publicized FHA action brings "headline risk" and unwanted investor scrutiny. For smaller companies, it prompts inquiries from important business partners (warehouse lenders, servicers). In short, reputational risk has always existed in the program and is paramount today because of FHA's higher enforcement focus.

Reputational risk is also on public display in FHA's Neighborhood Watch database that tracks early default and claim loan performance. In addition to targeting FHA audits and sanctioning lenders with high default rates, this database lets business partners, Congress, the press and public examine individual lender performance in any state, city or ZIP code in the country. Taken together, the "backloading" of loan compensation, reputational risk and transparency strongly influence lender behavior. Put another way, it is in the industry's self-interest to originate well-underwritten FHA loans.

While there is certainly little sympathy for the lender's plight in the housing crisis, I would be remiss if I did not mention that overlays also occur because the industry believes that there has been an overzealous use of sanctions by the government (primarily loan repurchases and now possibly significant penalties for servicing deficiencies). In the industry's view, one of the only ways to combat the government's approach to enforcement is to not make loans with a higher level of risk. (Lender concern is government-wide and not directed specifically at FHA.)

While some may view overlays as a way to further reduce risk in the system, they are lessening the value of government participation in the mortgage market and are having an adverse impact on the housing and economic recovery.

Ginnie Mae Program

Ginnie Mae is a monolined business focused solely on guaranteeing securities. Unlike Fannie Mae or Freddie Mac, it does not purchase loans and then issue securities. Its guaranty protects investors only.

As Ginnie Mae President Ted Tozer said in testimony before this Committee,

> "Ultimately, before Ginnie Mae's guaranty is at risk, three levels of protection must be exhausted: 1) homeowner equity, 2) the insurance provided by the government agency that insured the loans and 3) the corporate resources of the lender that issued the security. We are in the fourth and last loss position."

Like FHA, Ginnie Mae issuers (approved FHA lenders) have "skin in the game" since the lender who created the security remains financially responsible for the performance of the security. If borrowers miss their mortgage payments, the issuer must still advance the full principal and interest to Ginnie Mae every month. This financial liability is another reason why FHA lenders have put overlays in place on FHA and other government loans.

Ginnie Mae's finances are in excellent shape

Ginnie Mae earned more than $500 million in FY 2009 and FY 2010 respectively. It holds a $1 billion loss reserve and $14 billion in capital.

IV. Proposed reforms in Discussion Draft

Background

Before discussing the specific proposals, it is first appropriate to review the basic tenets of the FHA program and their impact on FHA's overarching objectives of assisting homebuyers not adequately served by the private sector while operating at no expense to the American taxpayer.

First and foremost, FHA is an insurance program. Like any successful insurance program, the FHA program must spread its risk across a broad enough group of borrowers to compensate for losses that will inevitably occur on some loans. Just like an auto insurer cannot be limited to drivers under the age of 25, FHA cannot be limited to borrowers with higher risk characteristics.

At the same time, FHA must balance the need to diversify its risk in order to protect the American taxpayer with the legitimate concern about the government encroaching too far into the private mortgage market. To address this issue, the Congress has used reasonable mortgage limits and a uniform premium structure to target FHA participation.

The challenge with mortgage limits in the FHA program is that higher balance loans perform better than lower balance loans. In the FY 2010 audit, it states

> "FHA experience indicates that more expensive houses tend to perform better compared with smaller houses in the same geographical area, all else being equal. The average houses in the marketplace, which have been the larger houses having FHA-insured mortgages, incur claims at a lower rate than smaller houses."

Concerning the FHA premium structure, unlike most insurers that charge insurance premiums based on risk (risk-based pricing), FHA charges all borrowers, with the same loan terms, the same mortgage insurance premium. In this way, borrowers with better credit characteristics enable FHA to assist borrowers who are in most need of FHA support. This principle of "cross-subsidization" also minimizes overlap with the private sector by "overcharging" borrowers with lower risk characteristics.

A risk-based premium structure has been debated for many years. In 1987, the Mortgage Bankers Association of America asked KPMG Peat Marwick to analyze the risk-based premium issue. KPMG stated:

> "By choosing this approach (risk-based premium), the FHA would have to charge premium rates that vary by as much as 300 percent to 400 percent from the lowest rate (e.g. low loan to value, high valued home) to the highest rate (e.g. high loan-to-value, smaller than average mortgage loan amount.)

The KPMG study supports the concept of "cross-subsidization". It keeps premiums lower for homebuyers who rely on FHA the most and "overcharges" lower risk borrowers. In addition, the KPMG study also confirms that higher balance loans have performed better than lower balance loans for many years.

In conclusion, any changes to the FHA program must balance the need to ensure FHA's financial soundness with the concerns about unnecessary overlap with the private sector.

Comments on Proposed Reforms in the Discussion Draft

I would like to provide specific comments on the following sections of the Discussion Draft. They are:

- Section 3 - FHA downpayment requirement of 5%

As the current FHA data presented earlier indicate, the performance of the FHA portfolio is improving. (Many FHA loans have downpayments of 3.5% or less). The Congress has already addressed the problem with FHA downpayments when it terminated the seller funded downpayment assistance program in 2008 and also raised the minimum cash investment requirement to 3.5%.

In addition, in a hearing before this sub-committee in March of last year, then-FHA Commissioner Stevens noted that the FHA volume would be reduced 40% if downpayments were increased to 5%. He also noted "downpayment alone is not the only factor that influences FHA performance". In fact, a low downpayment loan with a credit score over 680 performs better than a 10% downpayment loan with a credit score below 680.

Below is an excerpt from his written testimony.

> "Some have suggested that FHA raise the minimum required downpayment to 5% across the board and also remove the option of financing the upfront insurance premium into the loan balance for all transactions as a means to increase homeowner equity. We share the goal of increasing equity in home purchase transactions, but determined after extensive evaluation that such a proposal would adversely impact the housing market recovery.
>
> To determine the impact of requiring a minimum 5% downpayment for all transactions, FHA evaluated the loan files of a large sample of past endorsements to identify the number of borrowers who had sufficient assets at time of loan application to contribute the additional 1.5% of equity at closing. As illustrated in the table below, such a policy change would reduce the volume of loans endorsed by FHA by more than 40%, while only contributing $500 million in additional budget receipts. This translates to more than 300,000 fewer first-time homebuyers and would have significant negative impacts on the broader housing market - potentially forestalling the recovery of the housing market and potentially leading to a double-dip in housing prices by significantly curtailing demand. In contrast, the combination of policy changes proposed by FHA in the FY 2011 budget would contribute an additional $4.1 billion in additional receipts to FHA while having a much more moderate impact on the broader housing market."

"Impact of FY 2011 Policy Options on FHA Receipts and Loan Volume

Policy Option	FHA Receipts ($ Billions)	FHA Loan Endorsements ($ Billions)
Baseline without policy changes	$1.7	$246
Minimum 5% downpayment for all transactions	$2.2	$139
FY2011 Budget Proposal with all proposed policy changes	$5.8	$223

Furthermore, downpayment alone is not the only factor that influences loan performance. The combination of downpayment and FICO score is a much better predictor of loan performance than just one of those components alone. For instance, loans with a loan-to-value (LTV) above 95% **and** a FICO score above 580 perform better than loans with LTV below 95% **and** a FICO score below 580, while loans with a LTV above 95% **and** a FICO score below 580 perform significantly worse than all other groups, as illustrated below.

FHA Single Family Insured Loan Claim Rates Relative Experience by Loan-to-Value and Credit Score Values				
Ratios of each Combination's Claim Rate to that of the Lowest Risk Cell[5]				
Loan-to-Value Ratio Ranges	Credit Score Ranges			
	500-579	580-619	620-679	680-850
Up to 90%	2.6	2.5	1.9	1.0
90.1 - 95%	5.9	4.7	3.8	1.7
Above 95%	8.2	5.6	3.5	1.5

Source: US Department of HUD/FHA; March 2010.

- Section 4: FHA mortgage limits

While current temporary mortgage limits are set to expire in September 2011, this proposal would significantly lower FHA limits in many sections of the country by setting limits on a county by county basis. This proposal raises serious concern for three reasons. First, it would be an administrative "nightmare" to manage individual limits in over 3,000 counties. FHA mortgage limits could vary across streets in neighborhoods that are in different counties. In recent years, Congress had taken steps to address this problem by establishing mortgage limits for metropolitan areas. This proposal would reverse that approach.

Second, it will have the effect of increasing costs of homeownership for many families at a time when demand for housing is so weak. While FHA has raised its premiums to the highest levels in its history to protect the insurance fund, the GSEs have raised their fees even higher for homebuyers with better risk characteristics. (Private mortgage insurance fees are comparable to FHA depending on loan-to-value ratio.)

Finally, and arguably most importantly, lowering the FHA maximum loan amount to the extent contemplated in the proposal will have a negative effect on FHA's financial solvency. As noted earlier, higher balance FHA loans perform better than lower FHA balance loans all else being equal.

- Section 5 - FHA annual mortgage premiums

Since FHA no longer pays distributive share payments to homeowners after their FHA loan is terminated, I would oppose setting a minimum insurance premium. Over the years, FHA leadership has demonstrated that they will act responsibly in setting insurance premiums. An arbitrary minimum is inappropriate (unless FHA's mutuality feature is reinstated).

- Section 6 – Indemnification of mortgages

The Department should have the authority to require indemnifications for serious violations of the program requirements. I would encourage the Department to finalize its proposed rule on indemnification policy. In the proposed rule, FHA outlines the criteria for indemnification including the fact that the violation is "serious and material". Otherwise, the legislative provision could precipitate more overlays as lenders would be concerned that FHA, at some point in the future, could require indemnifications on minor administrative errors.

- Section 8 – Authority to terminate FHA mortgagee origination and underwriting approval

Similar to Section 6 above, FHA should have the authority to terminate FHA mortgagees for excessive early default and claim rates. Responsible lenders share the Congress' concern about poor performing lenders jeopardizing the FHA's finances and they are also frustrated to have to compete with such lenders in the marketplace.

However, it does raise questions about the evaluation process. Currently FHA's Neighborhood Watch database, which is the source for the early default data, does not distinguish between risk categories (for example credit scores or product type). Using credit scores as an example, FHA's average credit score is over 700. Accordingly, if a lender wanted to assist a borrower with credit issues, its performance would be compared to the FHA average (i.e. 700 credit score). It is highly unlikely that these loans will perform as well as the average FHA loan with a much higher credit score. There needs to be an "apples to apples" comparison process. Otherwise, FHA lenders must manage to the FHA average credit profile to minimize potential risk.

While both enforcement initiatives are reasonable (if implemented properly), they could encourage responsible lenders (that the provisions were never intended to affect) to tighten guidelines (i.e. more overlays) to protect their companies from potential financial/reputational risk.

- Section 9 – Authorization to participate in the origination of FHA-insured loans

This provision will enable community banks to more easily participate in the FHA program. It is administrative in nature and creates no additional risk for the program.

- Section 10 – Deputy Assistant Secretary for Risk Management and Regulatory Affairs

We have already seen the value of this position in the performance of Mr. Robert Ryan.

Other legislative and regulatory suggestions for the Subcommittee's consideration

1. I would add more transparency to the FHA program. Specifically FHA should be provided the funding to track early default loan performance by individual loan officers. If individual loan originators recognized that the performance of their originations would be tracked by the Department and available to the public, it would make loan originators much more sensitive to loan quality and reduce the potential for fraud and abuse. Presently, the poor performing originators simply move from one company to another after a problem is exposed. In this way, potential employers could see their performance.

2. FHA is considering changes to reinstate the Section 203 (K) investor program. FHA's investor problems in the 1990's were tied to non-profits. This change will facilitate the renovation of the housing stock.

3. FHA is also considering changes to its existing condominium program. The performance of existing condominium loans has been better than other "stick built" homes. FHA can rely on local approvals of existing condominiums.

4. In recent months, there has been discussion about changing servicing compensation levels to encourage better servicing of defaulted loans. In light of FHA's experience, I would be concerned that lowering the servicing fee on performing FHA loans would discourage loan quality. Servicers would no longer have a financial incentive to purchase quality loans. In fact, it would be in their financial interest to purchase loans more likely to default.

   I would also recommend the subcommittee consider a special program for the hundreds of thousands of homeowners who are still current on their loans but have been unable to refinance their homes and take advantage of lower interest rates because their homes are significantly underwater. These homeowners have "played by the rules" but have not been able to refinance solely because of matters outside of their control (their property value has declined). FHA could set up a separate program (not part of the Mutual Mortgage Insurance Fund) and charge appropriate premiums for the risk. I also think there was a study conducted in the Massachusetts area in early 1990's that found these loans performed extremely well. The property declines today are probably much more significant than occurred in early 1990's.

I know there are numerous hurdles to implementing a program of this type (e.g. pricing in secondary market), but it would be extremely helpful to many Americans who happened to buy a home at the wrong time.

In conclusion, FHA's performance indicates that, with full documentation, low-down-payment loans can be made on an actuarially sound basis. FHA's results counter the view that it was the GSEs' public purpose that precipitated their losses. FHA's portfolio is filled with a much higher share of loans with minimal down payments and lower credit scores than the GSEs acquired at the peak of the housing bubble. Unfortunately, as the GSEs' market share declined from 70% in 2003 to 40% in 2006, they responded to private-sector pressures by mirroring their products (e.g. low or no documentation, interest only and option ARMs).

Transparency is a strong deterrent to bad lending practices. It only takes a few well-publicized enforcement actions to reverberate throughout the industry and hurt reputations. FHA's data transparency (Neighborhood Watch) also gives business partners and the public the tools to evaluate originator performance.

The "originate to distribute" model and securitization have worked in the FHA/Ginnie Mae programs. However, they must be accompanied by "skin in the game, originator/issuer accountability and transparency. It is important that someone (issuer/servicer) in the mortgage process has long-term compensation incentives. It does not necessarily have to be the loan originator.

The mortgage market has been devastated by the financial equivalent of the 100-year flood. Yet the FHA, with all its limitations, is still operating without taxpayer assistance. As the Subcommittee looks for solutions to the problems facing the housing market, seeing what is working in the FHA program may be helpful in its deliberations.

Thank you for the opportunity to participate at this hearing. I will be pleased to answer any questions that you may have.

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

National Apartment Association

TESTIMONY BY
PETER EVANS
PARTNER
MORAN & COMPANY
ON BEHALF OF THE
NATIONAL MULTI HOUSING COUNCIL
AND THE
NATIONAL APARTMENT ASSOCIATION
BEFORE THE
INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY
SUBCOMMITTEE
OF THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
FOR THE HEARING ON
"THE FUTURE ROLE OF FHA AND GINNIE MAE IN THE SINGLE-
FAMILY AND MULTIFAMILY MORTGAGE MARKETS"

MAY 25, 2011

Chairwoman Biggert and Ranking Member Gutierrez, on behalf of this nation's 17 million households who call an apartment their home, the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) would like to thank you for the opportunity to testify today on the future role of the Federal Housing Administration (FHA) and the Government National Mortgage Administration (GNMA) in multifamily mortgage markets.

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is a federation of 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes.

We applaud your efforts to examine the role of FHA in America's housing market and ways to improve its ability to provide liquidity to key sectors of the rental housing market.

GROWING DEMAND FOR RENTAL HOUSING AGAINST A BACKDROP OF A SUPPLY SHORTFALL

Prior to addressing the role of FHA and GNMA multifamily finance programs now and in the future, it is worthwhile to take a moment and note the fundamental role multifamily housing plays in our nation's economy.

The U.S. is on the cusp of a fundamental change in our housing dynamics. Changing demographics and new economic realities are driving more people away from the typical suburban house and causing a surge in rental demand. Tomorrow's households want something different. They want more choice. They are more interested in urban living and less interested in owning. They want smaller spaces and more amenities. And increasingly, they want to rent, not own. Unfortunately, our housing policy has yet to adjust to these new realities.

Our society is changing in meaningful ways that are translating into new housing preferences. Married couples with children are now less than 22% of households and that number is falling.

By 2030, nearly three-quarters of our households will be childless. Seventy-eight million Echo Boomers are beginning to enter the housing market, primarily as renters. Seventy-eight million Baby Boomers are beginning to downsize, and many will choose the convenience of renting.

Beyond just changing demographics, there is also a much-needed change in consumer psychology underway that favors more long-term renters in the future. The housing crisis taught Americans that housing is shelter, not an investment. That awareness is freeing people up to choose the housing that best suits their lifestyle. For millions, that is an apartment.

Renting has many advantages. Convenience, walkable neighborhoods and mobility to pursue job opportunities are some of the reasons why renting is no longer something you do until you can buy a house.

Today, nearly 89 million Americans, almost one-third of all Americans, rent their home. There are 17.3 million apartments (properties with 5 or more units) in the U.S. that, taken together, provide a place to live for more than 14 percent of all households. In this decade, renters could make up half of all new households—more than seven million new renter households. Because of these changes, University of Utah Professor Arthur C. Nelson predicts that half of all new homes built between 2005 and 2030 should be rental units.

Unfortunately, supply is beginning to fall short of demand. An estimated 300,000 units a year must be built to meet expected demand. Yet most forecasts suggest ground will be broken on fewer than half that many in 2011. In fact, new multifamily construction set an all-time post-1963 low in 2010 at 97,000 new starts. That level of construction is not even enough to replace the units lost every year to demolition, obsolescence and other losses.

While there may be an oversupply of single-family housing, the nation could actually see a shortage of multifamily housing as early as 2012. The shortage is particularly acute in the area of workforce and affordable housing. The Harvard Joint Center for Housing Studies estimates a nationwide affordable housing shortfall of three million units.

This context is particularly important in understanding why it is vital that as Congress looks to reform housing finance, it do nothing that would jeopardize the construction, financing and availability of multifamily housing.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. As policymakers craft solutions to fix the single-family housing problems, they should be mindful not to do so at the expense of the much smaller and less understood, but vital, multifamily sector.

The government sponsored enterprises' (GSEs) multifamily programs were not part of the meltdown and are not broken. They have default rates of less than one percent—a tenth of those in the single-family sector—and they actually produce net revenue (profits) for the U.S. government. They pose no risk to the taxpayer.

Through careful underwriting, the GSEs' multifamily models have met the test. They have attracted enormous amounts of private capital; helped finance millions of units of market-rate workforce housing without federal appropriations; sustained liquidity in all economic climates; and ensured safety and soundness in their multifamily business. As a result of the liquidity provided by the GSEs, the United States has the best and most stable rental housing sector in the world.

Apartments are not just shelter. They are also an economic powerhouse. The aggregate value of this apartment stock is $2.2 trillion. Rental revenues from apartments total almost $120 billion annually, and management and operation of apartments are responsible for approximately 550,000 jobs.

FEDERAL SUPPORT OF THE MULTIFAMILY CREDIT MARKET

Multifamily Capital Markets Overview

Historically, the apartment industry has enjoyed access to mortgage credit from a variety of capital sources, each with its own focus, strengths and limitations. Private market sources include commercial banks, which offer short-term, floating rate financing for smaller, local borrowers. Life insurance companies target higher-quality properties in select markets. Their capital allocations change with market conditions, and their loan terms do not typically extend beyond 10 years. The commercial mortgage-backed securities (CMBS) market became a material source of capital for the industry in the mid-1990s but has been shut down since 2008, and it is unlikely to return to its pre-bubble levels of lending.

Even in healthy economic times, these capital sources have been insufficient to meet the full needs of the apartment sector, most notably the affordable and workforce housing sectors and rental housing in smaller markets.

To fill that gap, the federal government supports the multifamily housing finance market through three primary entities: the GSEs Fannie Mae and Freddie Mac; the Federal Housing Administration (FHA); and Ginnie Mae (GNMA). Each of these plays an important but different role in ensuring the availability of mortgage finance to the rental industry.

The GSEs have served as the cornerstone of the multifamily housing finance system for decades, offering a broad range of mortgage products, including long-term debt for the entire range of apartment properties (market-rate workforce housing, subsidized, large properties, small properties, etc.) in all markets (primary, secondary and tertiary) at all times regardless of economic conditions.

FHA was created in 1934 to insure multifamily loans originated by FHA-approved lenders to increase the capital availability to the industry. It offers high-leverage, long-term mortgages to many markets underserved by private capital. It primarily targets construction lending, although it is also available for substantial rehabilitation and acquisition and refinancing.

GNMA was established in 1968 to help create a secondary market for both single-family and multifamily FHA-insured loans. GNMA guarantees investors the timely payment of principal and interest on mortgage-backed securities (MBS) comprised of federally insured or guaranteed loans, including FHA loans. The GNMA guaranty allows mortgage lenders to obtain a more favorable price for their mortgage loans in the secondary market. Lenders can then use the proceeds to make new mortgage loans available. Notably, GNMA securities are the only MBS backed by the full faith and credit guaranty of the United States government, which means that even in troubled economic times, such as those that continue to confront the nation, investments in GNMA MBS are safe for investors.

FHA/GNMA: An Alternative Debt Capital Source and Private Sector Backstop

Since its inception in 1934, FHA has insured over 47,000 multifamily mortgages. It currently holds 13,000 multifamily mortgages in its portfolio (compared to 4.8 million single-family mortgages). While it accounts for just six percent of the total outstanding multifamily mortgage debt, it is a material and important source of capital for underserved segments of the rental market.

It is best known for offering construction loans to developers who lack access to bank and other private construction capital sources. It also serves borrowers with long-term investment goals as the only capital provider to offer 35-40-year loan terms. FHA lending is essential to borrowers in secondary markets, borrowers with smaller balance sheets, new development entities and non-profit firms, all of which are often overlooked by private capital providers.

FHA-insured debt has also been widely used by sponsors of targeted affordable housing and properties that receive federal, state and local subsidies, project-based Section 8 and proceeds from Low-Income Housing Tax Credits (LIHTCs).

FHA serves the multifamily market through three key programs.

- *Section 221(d)(3) and Section 221(d)(4) Mortgage Insurance Programs:* These programs are of the most importance to the conventional apartment industry. They insure mortgages for new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly and the handicapped. Section 221(d)(3) is used by nonprofit sponsors while Section 221(d)(4) is used by profit-motivated sponsors. Notably, the program enables GNMA to use mortgage-backed securities to provide liquidity support for long-term mortgages (up to 40 years), which leads to lower interest rates for borrowers.

- *Section 207/223(f) Program:* These mortgage insurance programs insure mortgage loans to facilitate the purchase or refinancing of existing multifamily rental housing that was originally financed with conventional or FHA-insured mortgages. Properties requiring substantial rehabilitation are ineligible for mortgage insurance under this program, though HUD permits the completion of non-critical repairs after endorsement for mortgage insurance. The Section 223(f) program enables GNMA to use mortgage-backed securities to provide liquidity support for long-term mortgages (up to 35 years), which leads to lower interest rates for borrowers.

CAPACITY AND PROCEDURAL OBSTACLES CREATE HISTORIC BACKLOG AT FHA

In normal capital markets, FHA/GNMA play a limited, but important, role in the rental housing sector. During the economic crisis, however, FHA became virtually the only source of apartment construction capital. Demand for FHA financing surged, increasing more than five-fold. Applications have increased from $2 billion annually to $10 billion, and HUD anticipates that demand for FHA multifamily mortgage insurance will remain high for the next several years.

FHA's lack of resources and recently implemented new processing procedures have created an enormous backlog of pending applications for new construction financing (through the 221(d)(3) and 221(d)(4) programs and refinancing for maturing mortgages through the 207/223(f) programs. As a result, FHA is struggling to meet this increased demand. Further exacerbating its capacity issues are efforts implemented over the past year to create stricter credit requirements through more stringent loan terms and expanded underwriting review. Additionally, FHA has recently revised its mortgage closing documents for the first time in 30 years. These changes mean that borrowers are subject to processing times that can exceed 18 months, and there are increasing questions over whether applications will move forward at all.

NMHC/NAA strongly support FHA's efforts to introduce sound credit and underwriting policies; however, these changes are disruptive to the critical housing needs of our nation's communities. Improvements cannot be undertaken at the cost of unnecessarily increasing government bureaucracy that results in a bottleneck of applications and the rejection of qualified development transactions. Multifamily rental developments financed through FHA create thousands of jobs and generate revenue for the federal government and communities; hence, delays at FHA miss an opportunity to contribute to the economic recovery. Moreover, the FHA multifamily program generates net revenues for the taxpayer—revenues that are forsaken when FHA is unable to process the applications in its pipeline.

Before examining the specific problems facing FHA in greater depth, we must note that HUD Secretary Donovan and his team are working diligently to resolve some of the issues we are raising today. In fact, NMHC/NAA, along with the National Association of Home Builders and the Mortgage Bankers Association, meet with top HUD officials on a quarterly basis to drive continued progress. All that said, while some progress has been made, it remains incomplete. Congressional action and vigilance will be required to ensure all problems are swiftly and satisfactorily addressed.

Loan Processing Issues

Increased demand for FHA financing has resulted in significantly longer loan processing times throughout the country. This is creating a significant hardship for apartment providers seeking to meet the nation's growing demand for rental housing.

In recent months, HUD has attempted to reallocate resources to high-demand offices and increase the amount of information offered to borrowers so they will better know their place in the pipeline. HUD has also clarified its application fee refund policies to enable would-be borrowers to withdraw their applications without material financial penalty when alternate financing is available.

Despite these efforts, applicants in many HUD field offices still have no idea how many projects are in the queue ahead of them or when HUD/FHA is likely to respond. We offer the following recommendations, which include some items HUD/FHA has already identified:

1. **Follow the Multifamily Accelerated Processing (MAP) Guide to ensure loans are processed efficiently.**
   HUD insists that transactions can be expedited through its MAP program; however, field offices often deviate from the guide, creating confusion among borrowers and lenders over what is required to secure FHA-insured debt. A more consistent application of the MAP Guide will eliminate this confusion and help reduce FHA's review time.

2. **Seek a more efficient means to address credit concerns.**
   As noted above, FHA has undertaken steps to strengthen the credit risk of its portfolio. However, some of these steps could be reworked in ways that would help expedite loan processing and still protect the agency. For instance, FHA has mandated that all loans over $15 million be processed by a National Loan Committee instead of being evaluated by the field office. This is an unnecessary complication. For years, FHA has relied on its lender partners to conduct due diligence, and the results have produced an FHA mul-

tifamily portfolio with acceptable credit performance. Instead of essentially abandoning this process, FHA should only require centralized review of loan requests that exceed the program's loan terms and requirements.

3. **Establish a special underwriting team for large, atypical loans.**
   While we agree that loans that exceed the general parameters of loans typically insured by FHA should be carefully examined, creating a special team to process them would relieve the clogs in the pipeline and expedite the processing of more standard transactions.

4. **Provide greater oversight over market assessment information.**
   HUD should use both appraisal data *and* the information provided by the Economic Market Analysis Division (EMAD) when reviewing applications instead of relying solely on EMAD data, which often is not an accurate assessment of local market conditions.

Resources

While some of the processing backlogs are a result of procedural obstacles, the greatest source of the problem lies in the insufficient staffing and financial resources available to FHA to meet current and future demand.

Although NMHC/NAA recognize that budget constraints confronting Congress and the nation make it unlikely that additional funding can be secured for administering the FHA multifamily mortgage insurance programs, we believe that existing resources can be reallocated to help alleviate bottlenecks.

Most notably, HUD can establish field office monitoring teams to evaluate and improve the ability of each FHA office to process applications, relative to their market share and based on the timelines set forth in the MAP Guide. Appropriators in Congress should give HUD the discretion to reallocate capital and staffing resources to offices that are the most efficient. Until then, however, HUD should not stand on the lack of such flexibility as a reason for the backlog instead of finding alternative solutions within its authority. For example, high-performing offices could be exempted from having the National Loan Committee review certain types of transactions that are unlikely to result in taxpayer losses. Finally, personnel in offices that are experiencing high volumes of applications could be supplemented by temporary duty assignments to help reduce backlogs.

FHA-RURAL REGULATORY IMPROVEMENT ACT OF 2011

The Committee has asked us to comment on its discussion draft, the FHA-Rural Regulatory Reform Act of 2011. While the bill predominantly addresses issues specific to the single-family and rural housing programs, there are several issues we want to raise regarding the FHA multifamily programs.

- *Loan Limits:* The current FHA multifamily loan limits are not high enough for properties that require elevator construction. Increases to the base loan limits and cost factors enacted over the past eight years have helped in many parts of the country, but they have not helped in urban areas where high-rise elevator construction is common As a result, there is a significant financing shortage in these areas, where demand for affordable and workforce housing is high.

  To meet the growing demand for affordable rental housing in urban areas, we propose a 50 percent increase in the FHA multifamily loan limits for elevator buildings. Elevator buildings are significantly more expensive to build, yet the loan limits for elevator buildings in FHA's most popular program, the 221(d)(4), are just 10 percent higher than garden apartment loan limits—$68,7000 for a two-bedroom in a high-rise versus $62,026 for a garden apartment. In a high cost market, the maximum elevator limit is $214,421 compared to a non-elevator limit of $195,382.

  Our proposal would increase the base loan limit for a two-bedroom unit in an elevator property from $68,070 to $93,039 (approximately a 37% increase). Adding the high-cost area factors to this base limit would allow FHA to insure loans in elevator structures of up to $293,073 per unit. Such a change would make a material difference in the amount of rental housing constructed in urban markets.

  Last year, the House passed bipartisan legislation to increase the FHA multifamily loan limits in high-rise elevator properties. We urge this Congress to address the demand for construction financing in our nation's cities by including those provisions in your forthcoming bill.

- *Capital Reserves.* We appreciate the Committee's efforts to improve the long-term viability of the FHA multifamily programs by implementing a risk-based capital reserve. We strongly support adequately capitalizing the General Insurance and Special Risk Insurance Fund (GI/SRI funds). However, the mortgage insurance premium for lower-risk loan programs should not be increased to subsidize higher-risk FHA insurance activities. Such transfer of risk-based capital could have a chilling impact on the multifamily programs if premiums are raised to subsidize losses in other loan categories.

FHA IS NOT THE SOLUTION TO THE CRISIS CONFRONTING THE GSEs

As this Committee and Congress examine ways to address the crisis confronting Fannie Mae and Freddie Mac, some have suggested that Fannie Mae and Freddie Mac's secondary mortgage programs be replaced by or merged with FHA. NMHC/NAA strongly oppose such efforts. Such a move would exacerbate liquidity issues facing the multifamily industry, which could reduce the availability of workforce housing and jeopardize the economic recovery.

There are many reasons for our opposition. Lawmakers should recognize that FHA serves a very different market than Fannie Mae and Freddie Mac. It provides capital to help develop and preserve rental housing where bank financing and other forms of capital are unavailable or in short supply. It should continue to perform this important mission, and an important element of housing finance reform should be to identify areas where it is appropriate for private capital and FHA to partner. But even such risk-sharing programs would not come close to meeting the apartment industry's broad capital needs.

Even if FHA served similar market segments to Fannie Mae and Freddie Mac, as our testimony suggests, FHA is woefully unprepared to assume greater responsibility. It is already failing to meet current multifamily program demand, and there is no expectation that the resources exist within the current budgetary framework to bring it to the level that it could replace the liquidity provided by Fannie Mae and Freddie Mac.

Beyond its general capacity issues, FHA also has insufficient capacity to effectively respond to the multiplicity of unique and often complex issues presented by income property underwriting.

This means that many viable deals that could lead to the construction of workforce housing might not be able to go forward simply because FHA would be incapable of structuring a deal.

FHA's limited and inflexible mortgage products do not fit the variety of needs of the market and market conditions. Again, this means that profitable deals Fannie Mae and Freddie Mac might be able to underwrite today would not go forward under a regime where FHA was the only government-backed market participant.

FHA also imposes arbitrary loan limits on its products that preclude credit in markets with significant land and development costs (i.e., high-cost markets). If FHA took over the activities of the GSEs, credit support could well be inadequate in urban markets nationwide, which would lead to reduced construction and very possibly a smaller number of units available to lower- and middle-income families.

It is also critical to note that FHA's mortgage documents are outdated and not considered to meet many market conventions and standards. Imposing these on the entire sector would expose the entire industry to significantly slow processing times currently being experienced by the small segment of FHA borrowers. It would also force multifamily firms to devote resources to the bureaucratic exercise of filling out forms instead of doing what they do best, namely constructing multifamily housing.

Finally, FHA has inadequate systems to oversee existing portfolios to manage credit risk and support prudent loan servicing. Whereas the GSE multifamily serious delinquency rates remain below one percent, moving operations to FHA could jeopardize this sterling record of success and unnecessarily leave American taxpayers open to billions of dollars in losses.

Instead of joining Fannie Mae and Freddie Mac with FHA, housing finance reform should seek to encourage partnership between private and FHA multifamily mortgage credit sources where appropriate. Although such areas may be limited, they should focus on the development and preservation of multifamily housing where bank and other forms of capital are unavailable or in short supply.

We believe there is a better solution than folding the GSEs' multifamily programs into FHA and that with more time and data from the Federal Housing Finance Agency (FHFA) we can develop a proposal to serve both the taxpayer and the millions of Americans who rely on rental housing for their shelter.

REFORM MUST PROTECT MULTIFAMILY PROGRAMS, DO NO HARM AND TAKE FACT-BASED APPROACH

While NMHC/NAA oppose merging GSE activities with FHA, we do strongly support housing finance reform and recognize the necessity of addressing the problems confronting Fannie Mae and Freddie Mac. That said, because of the multifamily sector's importance to the economy and prospects for recovery, proposals to address single-family housing problems must not be enacted at the expense of the very different, but vital, multifamily sector. Accordingly, we urge Congress to observe two principles *before* moving forward with any legislation:

First, proposals should do no harm to a multifamily sector that was not responsible for the financial crisis and, at the same time, is critical to ensuring a robust supply of workforce housing that will help drive our nation's economic recovery. Over 20 percent of all American households now live in apartment homes. In addition, demand for apartments is forecast to grow rapidly: In this decade, renters could make up half of all new households—more than seven million new renter households in total. Thus, public policy should take special care not to harm the planned production of workforce housing.

Moreover, while many have called for the elimination of Fannie Mae and Freddie Mac, this could have devastating consequences to multifamily housing if not done in a thoughtful and deliberative manner. Nearly all of the multifamily funding provided by the existing GSEs helped create workforce housing. In fact, fully 90 percent of the apartment units financed by Fannie Mae and Freddie Mac over the past 15 years—more than 10 million units—were affordable to families at or below the median income for their community.

Looking forward, it is hard to imagine a scenario in which necessary levels of workforce housing could be constructed without some level of government credit support, particularly during times of economic difficulty. Without government credit support of multifamily mortgages or mortgage-backed securities to ensure a steady and sufficient source of capital going forward, the apartment industry will be unable to meet the nation's housing needs in all markets, and Americans will pay more for workforce housing.

Finally, it is also critical for Congress to note that in stark contrast to the GSEs' single-family programs, the agencies' multifamily programs did not contribute to the housing meltdown. The risk models and underwriting standards Fannie Mae and Freddie Mac have used to produce millions of units of affordable housing work. In fact, Fannie Mae and Freddie Mac have actually earned net revenues exceeding $2 billion during conservatorship.

As a second principle, proposals to address Fannie Mae should only be enacted after the best available data has been made publicly available and analyzed. This will help Congress to avoid unintended consequences that could threaten the availability of workforce housing and ensure that future legislation reflects lessons that can be gleaned from Fannie Mae and Freddie Mac's activities prior to and following conservatorship.

We encourage House Financial Services Committee Chairman Bachus to request that the Government Accountability Office (GAO) conduct a study on the performance history of Fannie Mae and Freddie Mac's multifamily mortgage purchase activities since the enactment of the *Housing and Community Development Act of 1992* (P.L. 102-550).

NMHC/NAA believe that Congress should not move forward with comprehensive legislation addressing GSE multifamily mortgage activities until GAO obtains and analyzes data from the GSEs and FHFA that provides:

- An overview of the lending activities and multifamily housing mortgage products offered by the enterprises.

- Data regarding loan origination activities broken down by mortgage product, state and metropolitan area where the loans financed properties, the type of properties financed and the period of the loans (5-, 7-, 10-, 15-, 20-, 25- and 30-year mortgage terms) used for financing.

- An assessment of annual loan performance by product type based on debt coverage ratio and loan-to-value. This should also include an analysis of annual delinquency, default and foreclosure characteristics (in percentage and absolute numbers), and annual multifamily mortgage securitization activities.

- An examination of the credit standards and policy requirements the enterprises require for multifamily loans along with a comparison to other mortgage capital sources for both multifamily and single-family loans as available.

- Information about GSE multifamily loan loss reserves and their usage.

- An assessment of the enterprises' achievement of affordable housing goals, including multifamily contributions to corporate affordable housing goals and multifamily special affordable housing goals.

- An analysis of the enterprises' multifamily risk-sharing activities with the Department of Housing and Urban Development, the Federal Housing Administration, the Rural Housing Administration, and state and local housing finance agencies.

In closing, NMHC/NAA look forward to working with this Committee and the Congress to reform the nation's housing finance markets while ensuring that a robust supply of capital is available to provide for a sufficient supply of workforce housing that is so necessary to driving a sustained economic recovery.

Thank you again for the opportunity to testify this afternoon, and I stand ready to answer any questions you may have.

TESTIMONY

Future Role of FHA and Ginnie Mae in the Single-Family Mortgage Markets

Basil N. Petrou
Managing Partner
Federal Financial Analytics, Inc.

Before the

Insurance, Housing and Community Opportunity Subcommittee of the Committee on Financial Services

United States House of Representatives

May 25, 2011

It is an honor to appear before this Subcommittee today to testify on reform of the Federal Housing Administration (FHA) single-family mortgage insurance program and of the Government National Mortgage Association (Ginnie Mae). I am Basil N. Petrou, managing partner of Federal Financial Analytics, a firm which provides consulting services on, among other things, the array of policy issues affecting single-family residential mortgage finance.[1]

As the Subcommittee knows, these issues are perhaps the most important challenge for this vital sector of the U.S. economy. Numerous policy, regulatory and private-sector errors contributed grievously to the boom in mortgage finance and, now, to the bust in this sector that has led to virtual complete government control. Righting the balance between taxpayer support and private capital is in my view the most critical challenge that must be addressed to restore a vibrant, prudent and stable financial system for single-family mortgages through the origination and securitization chain.

All too often, advocates suggest that private capital will take charge of residential-mortgage finance if Fannie Mae and Freddie Mac are privatized or otherwise forced out of the market. This, though, will not occur if the FHA and Ginnie Mae are left as is. Reform of the

[1] Since 1985, Federal Financial Analytics, Inc. has provided analytical and proprietary advisory services to private corporations and government agencies in the U.S. and other major financial centers. The firm's practice includes a focus on U.S. residential-mortgage finance, including analysis of legislative, regulatory and policy matters governing issues such as the role of the FHA, the structure of the GSEs, pending efforts to reform asset-backed securities, U.S. and global regulatory-capital regulation and similar matters. The firm has frequently testified before the U.S. Congress on these matters (see WWW.FEDFIN.COM) and has otherwise been honored to participate in the public debate on these vital matters. Federal Financial Analytics, Inc. does not lobby on behalf of any clients.

government-sponsored enterprises (GSEs) without parallel and companion efforts to restructure the FHA and Ginnie Mae will not reduce taxpayer risk, but only shift it and, perhaps, exacerbate it because of the full-faith-and-credit backstop accorded FHA.

I thus would like at the outset to commend the Subcommittee for its attention to the urgent question of FHA and Ginnie Mae reform. It is my hope that the Subcommittee quickly advances the legislation proposed in conjunction with this hearing, bearing in mind the specific recommendations I shall offer in the body of this statement. In summary, I urge the Subcommittee to:

Ensure the Return of Private Capital to U.S. Mortgage Finance

Much is said of the need for private capital, but many policy recommendations seemingly aimed at this goal in fact would undermine it. An example is the pending inter-agency proposal to implement the risk-retention requirements mandated by Section 941 of the Dodd-Frank Act.[2] Because the law excepts FHA and the rule would impose stringent risk-retention requirements on all mortgages with downpayments of less than twenty percent, low-downpayment lending will flow to the FHA. This is contrary to Congress' stated intent in the Dodd-Frank Act and the goal of the Subcommittee's new FHA-reform proposal.

Balance FHA/Ginnie Mae Reform with that of the GSEs

This Subcommittee has jurisdiction only over the legislation before it, but the proposal comes of course in tandem with Committee efforts to rewrite the GSEs. The Administration

[2] 76 Fed. Reg. 24090 available at http://edocket.access.gpo.gov/2011/pdf/2011-8364.pdf.

has rightly focused on implementing a "wind-down" strategy for the GSEs in concert with changes to the FHA so that the U.S. residential-mortgage secondary market does not become the sole province of entities backed directly or indirectly by the taxpayer. As FHA reforms in areas like pricing and loan limits advance, so too should those for Fannie Mae and Freddie Mac.

The draft legislation considered today is a vital first step towards a newly-rebalanced policy on mortgage finance. Key provisions in it that I support include:

- the increase in the minimum borrower downpayment to five percent, which – when combined with the prohibition against the financing of closing costs – will increase the "skin in the game" contributed by borrowers. These requirements will not adversely affect first-time or low- and moderate-income home buyers, but they will provide better discipline for prudent mortgage origination and sustainable home ownership;
- the elimination of the FHA national loan-limit floor, which will rightly refocus FHA on the segment of the market suitable for first-time and low- and moderate-income buyers;
- the establishment of minimum FHA mortgage insurance premiums, essential to rebuilding the solvency of the FHA and, thus, to reducing taxpayer risk; and
- improvements in the powers of the FHA to terminate or discipline lenders and to require indemnification from them.

However, it is vital to connect the first set of issues I have noted – the need for real private capital and a balanced role for the U.S. Government – with the specific objectives addressed in this legislation. To do so, I recommend not only enactment of the provisions noted above in this bill, but also legislation and policy changes to:

- modify the 100 percent full-faith-and-credit guarantee provided by the FHA for all loans it insures. It's simply impossible for there to be real incentive alignment between originators and the U.S. taxpayer if originators take all the profit and the U.S. taxpayer takes all the risk. Further, the full-faith-and-credit backstop distorts the U.S. financial system and global capital markets because capital regulations and many other provisions strongly favor obligations of this sort over those backed by private capital, creating a high barrier to the re-entry of private capital to U.S. residential-mortgage finance;
- allow FHA to share risk with private capital, perhaps beginning with limited programs to ensure that risk shares are indeed robust and that price appropriately reflects this risk share instead of providing a back-door subsidy that permits a resumption of risky loan-origination practices; and
- target the FHA to borrowers based on income, not home price. Currently, high-income borrowers are often eligible for full-faith-and-credit U.S.-backed mortgages even though the private market for their mortgages would otherwise be deep, liquid and efficient. When the U.S. Government supports mortgage finance for higher-income borrowers, it supplants private capital otherwise ready to take on this risk.

In the balance of this testimony, I will address each of these specific issues in detail.

Borrower Downpayments Can and Should be Increased as Proposed

The Subcommittee legislation would:

- increase the minimum downpayment from 3.5 percent to five percent of appraised value; and
- disallow any initial service charges, appraisals, inspections or other closing costs from the financed amount.

Current FHA policy combines a low nominal downpayment with authority to include significant closing costs in the financed amount as well as the upfront FHA insurance premium. While the payment of closing costs cannot be used to meet the 3.5 percent minimum downpayment requirement, the fact that closing costs can be included in the financed loan amount means that the borrower starts with a 96.5% initial loan to value calculation before consideration of seller contributions and the financed upfront FHA premium.

In a world of unstable house prices, beginning ownership with a bare minimum 3.5 percent equity interest in a house means that the borrower is vulnerable to even relatively slight house price reductions. If house prices fall, first-time buyers will see their equity wiped out very quickly. This is of course highly problematic for borrowers, for their communities and for the solvency of the U.S. mortgage-finance system.

First, it leaves borrowers at risk for even small adverse events like broken pipes, let alone enabling them to undertake the significant improvements often required at FHA-financed properties where home-inspection and/or appraisal processes have been rightly called into question. If a borrower were to lose his or her job and need to move to a new location, the combination of even a slight decline in house prices plus the transaction costs needed to sell the house means the borrower will not be able to pay off the FHA mortgage from the proceeds from the sale of the home.

In the past, borrowers often were persuaded that owing more than the house is worth was warranted because house-price appreciation will simply make up the difference. Of course, to obtain cash from house-price appreciation requires refinancing a mortgage, which borrowers all too often did through products that undermined sustainable home ownership instead of enhancing it. Hopefully, those products are gone and will not reappear. However, as a government program, FHA should assume as its top priority putting first time homebuyers into homes they can afford to keep.

However, neither the FHA nor other pending policy initiatives should demand such high downpayments that home ownership becomes prohibitive for many Americans and housing-market recovery is placed in still greater jeopardy. The inter-agency proposal noted earlier to implement Section 941 of the Dodd-Frank Act specifies that a "qualified residential mortgage" (QRM) exempt from risk retention would need to have at least an twenty percent downpayment and does not permit offsetting this requirement through the use of private mortgage insurance (MI). This proposal would gravely undermine the Subcommittee's goal of a targeted, prudent role for the FHA because all too many eligible borrowers for low-risk mortgages will be frozen out of the private mortgage-finance system. Many families who bought during the market boom have lost equity in their existing homes. These low downpayments, repeat buyers and first-time homebuyers who need private, low-downpayment options are a large part of the current housing market and are critical to the housing recovery. The National Association of Realtors estimates that 75 percent of all buyers – first-time buyers and repeat buyers – financed eighty percent or more of their home purchase in 2010.[3]

Thus, it is vital to balance downpayment requirements to promote the goals of sustainable home ownership, an appropriate role for the FHA and the recovery of the U.S. mortgage market. In my view, the legislation's proposed five percent minimum downpayment and financing-amount restrictions do so, while the pending QRM rule would undermine any hope of an appropriate balance or near-term recovery in the housing market.

The FHA national loan limit floor should be eliminated.

Currently, FHA is authorized to insure a loan equivalent to 115 percent of the median house price in an area, subject to two restrictions. First, a national loan limit floor has been set at 65 percent of the GSE loan limit. Today, FHA can insure a loan if the insured amount is less than or equal to $271,050 and it does not exceed 115 percent of the median house price in the geographic area.

[3] National Association of Realtors, *Profile of Home Buyers and Sellers 2010* (Nov. 2010), p. 71, Exhibit 5-3, *available at* http://realtor.org.

Home prices have fallen across most of the country in the past few years and the current FHA national loan limit floor is thus at least sixty percent higher than the national median existing house price, which (according to the National Association of Realtors) has been stable for the last three years at between $160,000 and $170,000.[4] The FHA national loan-limit floor is even higher than the median existing house-sale price for most counties in California – considered the highest cost area of the country -- and it is just slightly below the median sales price in metropolitan Los Angeles.[5] Thus, the current FHA national loan-limit floor means that, for entire states, the FHA is insuring loans that are well above 115 percent of the area median house price in that state and well above the mean for even middle-income homebuyers. The FHA national loan limit floor set at this level effectively guts the FHA's mission of targeting low- and moderate-income borrowers, permitting the U.S. to back borrowers with the highest incomes in their local areas and driving out the private capital that would otherwise support these mortgages.

The pending legislation rightly eliminates the national loan limit floor. Instead, the FHA would be allowed to insure only mortgages at 125 percent of the median house price in the county in which the property is located. This county-of-location approach eliminates the current upward-price bias in determining the relevant "area" which now looks to the highest-priced county in a metropolitan statistical area.

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[4] See National Association of Realtors press release on May 19, 2011 entitled *April Existing Home Sales Ease*, which notes the national median existing house price sale in April was $163,700.

[5] See press release and attachment from the California Association of Realtors dated May 16, 2011 and entitled *April 2011 Sales and Price Report.* The press release notes that the statewide median price for a single family detached house was $293,570, the median price in the Los Angeles metro area was $277,300 and that the median price in 22 California counties was below $271,050.

Further, the bill would reduce the allowance over the national loan-limit floor for "high-cost" areas. Now, this is set at 175 percent of the GSE loan limit ($729,750); the bill would reduce this to 150 percent of the GSE limit, meaning that FHA could insure loans of no more than $625,500. This contributes to a return of the FHA to its proper focus although, as discussed below, I believe FHA should be still more tightly circumscribed to the appropriate role for the federal government: insuring only mortgages that meet income-based targets that focus the program on low- and moderate-income borrowers.

The FHA Annual Premium Should be No Less Than 55 Basis Points.

Under the pending legislation, FHA would be required to charge an annual insurance premium of no less than 55 basis points and no higher than 150 basis points. This changes current law, which permits (but does not require) the FHA to charge an annual premium and sets the maximum -- but not the minimum -- amount of the premium. The bill would thus direct that the premiums not be an option, but rather become a requirement, thus helping to rebuild the FHA single family fund.

To be sure, The Department of Housing and Urban Development (HUD) in April set new premiums that reflect the need to rebuild the Mutual Mortgage Insurance (MMI) Fund. However, there is no guarantee absent statute that HUD policy going forward will always reflect this critical discipline. Reducing the annual premiums below 55 basis points would jeopardize the MMI Fund, which is barely meeting its statutory capital requirements. This was most recently made clear by the Congressional Budget Office (CBO), which last week concluded that a fair-value analysis of the MMI Fund shows that the Fund has a negative capital ratio – in sharp contrast to the positive balance now reported under federal budgeting procedures.[6] Congress should ensure that it carefully reviews any future "price-cutting" by FHA so that the MMI Fund is not placed at risk for "marketshare" or similar objectives that might again determine FHA policy.

Congress Must Enhance FHA and Ginnie Mae Efforts to Improve Risk Management

The proposed legislation would allow the FHA to require a lender to indemnify it if the Secretary of HUD determines that a loan was not originated or underwritten in accordance with FHA standards and FHA has paid an insurance claim. Additionally, the bill would authorize HUD to demand indemnification in cases of fraud or misrepresentation even if a claim has not been paid. This authority is comparable to that now exercised by private mortgage insurers, who rescind insurance when relevant terms and conditions are not met.

Private insurers do this because paying claims on loans originated without compliance with set standards or, worse, in fraudulent or similar cases is akin to paying claims for fire damage caused by arson. This is not proper insurance policy for the private sector and it is just as risky for FHA as a government program.

[6] See letter dated May 18, 2011 from Douglas W. Elmendorf to Congressman Paul Ryan with attachment entitled Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair-Value Basis. The letter notes that under the Federal Credit Reform Act of 1990 the FHA MMI Fund produces budgetary savings of \$4.4 billion in FY 2012 but on a fair value basis the program would impose a budgetary cost of \$3.5 billion.

Finally, the legislation would create a Deputy Assistant Secretary of HUD for risk management at the FHA and mandate a chief financial officer (CFO) at Ginnie Mae. Both of these positions are needed and the legislation rightly ensures that they are established and maintained to enhance ongoing efforts to improve internal controls at these agencies. Similarly, the bill requires the Secretary of HUD to conduct an examination of FHA programs to improve their efficiency, requiring a report to Congress on recommendations resulting from this examination within one year of enactment. FHA has programs long in existence without demonstrable result, and this review will ensure the ground-up analysis required to focus FHA on its vital role of ensuring sustainable home ownership for low- and moderate-income borrowers.

Congress Should Provide FHA with More Pilot Program Flexibility

In conclusion, I would like to suggest to the Committee a few additional legislative changes to the FHA which would allow FHA to initiate pilot programs to test the best way to alter its future activities to better serve low and moderate income borrowers and to protect the taxpayer. Pilot programs should be authorized as follows:

- Instead of targeting house price, the FHA should be allowed to target borrower income as it relates to the median family income in the metropolitan statistical area in which the house is located. The advantage of this approach is that it sharply limits gaming of the FHA loan amounts in future years as median family income in an area fluctuates far less than median house price over time. It also allows the effect of changing mortgage interest rates on qualifying borrowers to be factored into FHA loan exposure. This approach does not need to be uniform nationwide. Some areas could have the limit set at 125% of median family income to reflect their lower rate of home ownership, while other areas with high homeownership rates could have the income limit set at 85% of median family income to address homeownership needs of low and moderate income families in that area.

- FHA should insure less than 100 percent of the loan amount where appropriate. Indeed, the MMI Fund would be far healthier over time if the borrower and lender both were required to have more "skin in the game." The current VA program is an example where less than 100% coverage (VA coverage starts at 50% for lower loans amounts and falls as the loan amount increases) is currently implemented with Ginnie Mae. Congress could have FHA insure thirty percent of a loan amount in areas where there is already a high homeownership rate and where borrower incomes are sufficient to meet housing needs. However, in those inner-city areas where homeownership is low and house prices are uncertain, the FHA could insure 85 percent of the loan amount to provide lenders with an incentive to advance funding.

- FHA should experiment with risk sharing programs with the private sector. FHA currently has authority to enter into a risk share pilot program with private insurers where the insurer reinsures the FHA risk.[7] This authority should be amended to allow FHA to experiment with risk sharing where the private insurer takes a first-loss position and the FHA assumes a second-loss one or partially reinsures the private coverage. These approaches would significantly reduce taxpayer risk resulting from the FHA both due to the direct risk-absorption provided by private capital and through the significant, if indirect, benefit of having private capital at risk provided through an independent second underwriting of the loan. This would sharply enhance the risk-management discipline FHA is seeking that the pending legislation also would promote, but it would do so through capital at risk, not new offices or internal procedures that must be carefully followed and fully implemented to have any real effect over time.

[7] 12 USC 1725z-14.

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RON PHIPPS, ABR, CRS, GRI, GREEN, E-PRO, SFR
2011 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

HEARING REGARDING

LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS AND GNMA IN THE SINGLE-AND MULTI-FAMILY MORTGAGE MARKETS

MAY 25, 2011

Madam Chairwoman, Ranking Member Guittierez, and members of the Subcommittee, my name is Ron Phipps, and I am the 2011 President of the National Association of REALTORS®. I am proud to be part of a four-generation, family-owned residential real estate business in Rhode Island. My passion is making the dream of home ownership available to American families. I am proud to testify today on behalf of the more than 1.1 million REALTORS® who share that passion, and the 75 million Americans who own homes and the 310 million Americans who require shelter.

We thank you for the opportunity to present our views on the importance of the Federal Housing Administration (FHA) mortgage insurance program. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

Comments on Discussion Draft

Madam Chair, we appreciate your attention to the importance of FHA, especially during these difficult times and thank you for attempting to provide FHA with all the tools it needs to remain an important part of our housing finance system.

The Discussion Draft being considered today provides for a number of valuable enhancements that will help FHA remain fiscally strong. The National Association of REALTORS® strongly supports

Sections 6-12 of the bill, which will allow FHA to better monitor risk, increase enforcement tools, and strengthen protections for taxpayers. We also thank you for your attention to Section 13, proposing to move the Rural Housing Service out of the Department of Agriculture and into the Department of Housing and Urban Development. We appreciate your consideration of the critical impact rural housing programs have on tens of thousands of rural communities. NAR is still evaluating the impact of moving these entities to HUD on important programs like the 502 single-family loan programs and the 515 rural rental housing program. These programs are especially important to rural families, as private sector lending will be even slower to return to these communities.

As is discussed later in this testimony, NAR strongly opposes increasing the downpayment for FHA. The correlation between downpayment and loan performance is significantly less important than the linkage to strong underwriting, which FHA continues to have. FHA's foreclosure rate remains less than conventional mortgages, so we don't believe changes to the downpayment would do anything but disenfranchise many creditworthy homebuyers. In addition, NAR also strongly opposes the proposed changes to the FHA mortgage limits. Our housing recovery remains fragile at best, with home sales now trending down. As NAR's Chief Economist, Dr. Lawrence Yun has said, "Although existing-home sales are expected to trend up unevenly through next year, unnecessarily tight credit is continuing to restrain the market." Changing the loan limits at this critical time will only serve to restrain liquidity and hamper the recovery. We strongly urge the Subcommittee to support H.R. 1754, introduced by Reps. Miller (R-CA) and Sherman (D-CA), which would make the current limits permanent.

FHA has been a critical part of our nation's economic recovery, and has outperformed all expectations in their role of providing safe, affordable, mortgage financing to all markets during all economic conditions. This is due, in part, to a number of changes already made to the program in the last 18 months, and which are demonstrating results. FHA's average credit score is up to 703; default rates, which were already low, are decreasing even further. We strongly urge the Subcommittee not to make any additional changes that would unnecessarily constrain this valuable program that has served so many deserving American families for decades.

FHA's Historic Mission

The Federal Housing Administration (FHA) was created by the National Housing Act of 1934. FHA does not make loans but insures mortgage loans made by private lenders. FHA has insured more than 50 million purchase money and refinance mortgages since 1934 and currently has 4.8 million loans in its portfolio.[1] FHA revolutionized the real estate industry with the creation of the 20-year mortgage, which led to the 30-year mortgage that is standard today.[2] FHA has successfully operated for seventy-seven years as a self-sufficient entity, and without expense to the American taxpayer.

When the FHA was created by the 1934 National Housing Act, the primary goal of the Administration was to insure loans for home improvements.[3] In the wake of the Great Depression, the nation's housing stock was crumbling. Houses were not being maintained or modernized and the result was deteriorating living conditions and falling home prices. At the same time, painters,

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[1] History of FHA. http://www.hud.gov/offices/hsg/fhahistory.cfm
[2] FHA-Insured Home Loans: An Overview. Foote and Jones. January 18, 2011. P.1
[3] 13 Wayne L. R. 651, 652 (1967)

carpenters, landscapers, and more of the dozens of trades involved in home improvements were without work. By creating an agency to insure small, private capital loans for home improvements, the federal government hoped to address these two issues simultaneously.

While home improvement loans were the first goal of Title I of the National Housing Act of 1934, the full scope of the law went further. According to the 1934 Report of the House Committee, the intent of the National Housing Act of 1934 was:

> "to improve Nation-wide housing standards, provide employment, and stimulate industry; to improve conditions with respect to home mortgage financing, to prevent speculative excess in new-mortgage investment, and to eliminate the necessity for costly second-mortgage financing, by creating a system of mutual mortgage insurance and by making provision for the organization of additional institutions to handle home financing . . . ." [4]

Most of these goals have been achieved through what would become the Act's most enduring legacy: mutual mortgage insurance. Contained in Title II of the National Housing Act, FHA's mutual mortgage insurance first insured loans up to $16,000 for the purchase of homes and made these loans amortizing over a 20-year period. Up to this point, most home loans were five to ten year balloon loans that had to be refinanced every few years, creating uncertainty for both banks and homeowners as to the feasibility of refinancing. By giving loans an amortizing structure, the government hoped to introduce predictability for both homeowners and lenders.[5]

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[4] H.R. Rep. No. 1922, 73d Cong., 2d Sess. 1 (1934)

[5] First Annual Report of the Federal Housing Administration for the Year Ending December 31, 1934. U.S. Government Printing Office. 1935. p. 4

A common misconception exists that FHA was intended to only benefit low-income borrowers who could not afford a large down payment on a new home. While an upper limit of $16,000 for a home loan may seem exceptionally small today, in 1930 the national median home value was $4,778.[6] The majority of homes were valued between $2,000 and $7,500, with the largest number of them falling between $3,000 and $5,000.[7] Only 3.2 percent of homes were valued between $15,000 and $20,000.[8] So the upper limit of $16,000 was more than 330 percent of the median American home value at that time. Contrast that to today, where even the current higher loan limits are only at 125 percent of the local area median home price. Even at its inception, FHA was intended to provide safe, affordable mortgage financing for all homebuyers in all markets – high and low cost.

FHA Enhancements Over Last 18 Months

Over the last year, FHA has taken several administrative steps to mitigate risk that have resulted in great improvements to loan performance in the MMIF. These steps include increasing mortgage insurance premiums on two separate occasions, stepping up enforcement that resulted in suspending or withdrawing FHA approval for 1,500 lenders, hiring the agency's first Credit Risk Officer, implementing a credit score floor, requiring a greater downpayment for borrowers with lower credit scores, adopting a series of measures to increase lender responsibility and enforcement, and publishing a proposed rule to reduce permitted seller concessions. A brief description of the major initiatives follows.

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6 Id. at 18
7 Id.
8 15th Census of the United States, Population, Volume VI: Families, U.S. Census Bureau, 1930, P. 17

Increased MIP

In April 2011, mortgage upfront insurance premiums on FHA-backed loans increased to 2.25 percent from 1.75 percent. That amounts to an additional $500 for every $100,000 in borrowing[9]. On a $300,000 loan, for example, a borrower will pay $6,750 upfront in insurance costs, compared to $5,250 at previous levels. Effective October 4, 2010, FHA increased the annual premium to 0.85 percent from 0.50 percent for loans with loan-to-value ratios (LTV) up to and including 95 percent and to 0.90 percent from 0.55 percent for LTVs above 95 percent. This added an estimated $300 million per month to the FHA fund. However, the combined premium increases raised the cost of housing by approximately $75 per month.

Credit Risk Officer

In October of 2009, FHA hired the first Chief Risk Officer in the organization's history. On July 28, 2010 FHA received Congressional approval to formally establish the position and create a permanent risk management office within FHA. The Risk Officer is now Deputy Assistant Secretary of this office. At the time, then FHA Commissioner Stevens testified that "[w]ith this new office and additional staffing, we have begun to expand our capacity to assess financial and operational risk, perform more sophisticated data analysis, and respond to market developments."

Seller Concessions

In July 2010, FHA published a notice that proposed to reduce permitted seller concessions to three percent. FHA currently allows for seller concessions up to six percent and concessions exceeding six

[9] Wall Street Journal blog. http://blogs.wsj.com/developments/2010/04/02/fha-mortgage-insurance-premiums-set-to-increase/

percent must be treated as inducements to purchase, resulting in a reduction in the FHA mortgage amount. FHA reasoned that conventional mortgage lenders have capped seller concessions at 3 percent of the sales price on loans with LTV ratios similar to FHA. Loans guaranteed by the Department of Veterans Affairs cap seller concessions at 4 percent of the sales price. In the notice, FHA shows that borrowers who received more than 3 percent in seller concessions had a significantly higher risk of losing their homes. While seller concessions above 3 percent would not be prohibited under this proposal, concessions that exceed FHA's 3 percent cap would be required to result in a dollar-for-dollar reduction in the sales price for the purpose of calculating the maximum FHA loan amount.

Credit Score Floor

Effective October 4, 2010, borrowers with a credit score below 500 are not eligible for FHA-insured mortgage financing. Borrowers with a credit score between 500 and 579 are limited to 90 percent LTV, which requires a 10 percent downpayment. Borrowers with a credit score of 580 or higher are eligible for maximum financing, which requires a minimum 3.5 percent downpayment. Borrowers with nontraditional credit histories may be eligible for maximum financing. In conjunction with updated down payment and credit score guidelines published on September 3, 2010, the changes to FHA's premium structure are projected to result in an additional $4.1 billion in FHA receipts in FY 2011.

Third Party Originator Policy

In a November 30, 2009, proposed rule[10], HUD advised that loan correspondents would continue to have the opportunity to participate in the origination of FHA mortgage loans as third-party originators (TPOs) through association with an FHA-approved mortgagee, but TPOs would no longer be subject to the FHA lender approval process. Since HUD would no longer be approving loan correspondents, FHA-approved mortgagees would assume full responsibility to ensure that their sponsored TPOs adhere to FHA origination and processing requirements. Responsibility for actions of TPOs is not a new responsibility for FHA-approved mortgagees. Only FHA-approved mortgagees would be allowed to submit loan documents to FHA to obtain FHA case numbers.

In the 111th Congress, the Senate failed to approve House-passed legislation permitting the loan to close in the originator's name, so any legislative fix in the 112th Congress must pass both Houses of Congress again. Accordingly, it is now unlikely that a sponsored originator will be able to close an FHA loan in its own name for the foreseeable future.

Impact of Changes

Combined, these changes have lead to a stronger, safer, well-performing government mortgage insurance program. Making the additional proposed changes at this time would only stress an already fragile economic recovery, and could cause a so-called "double dip" in the housing crisis. NAR strongly opposes those changes that will impact liquidity and the ability of credit-worthy borrowers to own their part of the American dream.

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[10] Federal Register Docket No. FR 5356-F-02, RIN 2502-A181. Strengthening Risk Management through Responsible FHA-Approved Lenders. http://portal.hud.gov/hudportal/documents/huddoc?id=FHARISKMGMTFINRULEWEBPOST.pdf

FHA's Role in Multifamily Markets

As in the single-family market, FHA's role in multifamily mortgage markets has never been more critical. More than 1/3 of American families rent their homes, and keeping a sufficient supply of affordable rental housing is essential. Without the liquidity provided by FHA multifamily mortgage insurance, these markets would be stalled.

In recent years, FHA's role in the multifamily market has increased dramatically – nearly 4 times its size from just several years ago. As lenders remain slow to provide financing for construction loans, FHA is the primary source of construction for multifamily developers and owners. Again, this demonstrates FHA's ability to step up and fill the gap when private markets will not or cannot act.

FHA has implemented a number of new procedures and requirements for its multifamily loans. They have strengthened underwriting by changing ratios and increasing documentation. They have also implemented a number of oversight and risk-management provisions.

In response to the increased demand and the changes to the program, FHA's ability to meet the needs of developers to create affordable rental housing has been challenged. FHA is working hard to meet the new demands responsibly. We urge them to look for ways to streamline procedures.

Multifamily Loan Limits

Last year, Congress passed legislation to increase the FHA Multifamily loan limits in high-rise properties. High rise construction has costs significantly different than garden-style apartments. Yet the loan limits for the two are nearly the same. Because the so-called "elevator" limits are so low, many urban areas have not had any properties endorsed with FHA multifamily insurance in the last several years. Since there is very limited private capital available, and high demand for affordable rental housing, our nation's urban dwellers are suffering. We urge this Congress to pass similar legislation to increase the elevator loan limits for multifamily to assure all our nation's families can find affordable rental housing.

FHA's Performance

Much has been made of FHA's audit that showed the capital reserves falling below 2 percent. The biggest contributor to FHA's audit findings is housing prices. As housing prices have fallen, so has the value of FHA's portfolio. This has nothing to do with the quality or the loans or the qualifications of the buyers. As a Congressional Research Service (CRS) report, published November 23, 2009, stated "FHA would not be able to prevent defaults arising from deteriorating financial and macroeconomic conditions."[11]

In fact, NAR believes that FHA has shown incredible strength in weathering this storm. Unprecedented declines in housing prices coupled with the rising levels of unemployment that this nation has experienced in the last few years have caused massive losses in lending institutions and even the GSEs. But FHA has persevered, and thanks to their strong underwriting requirements and

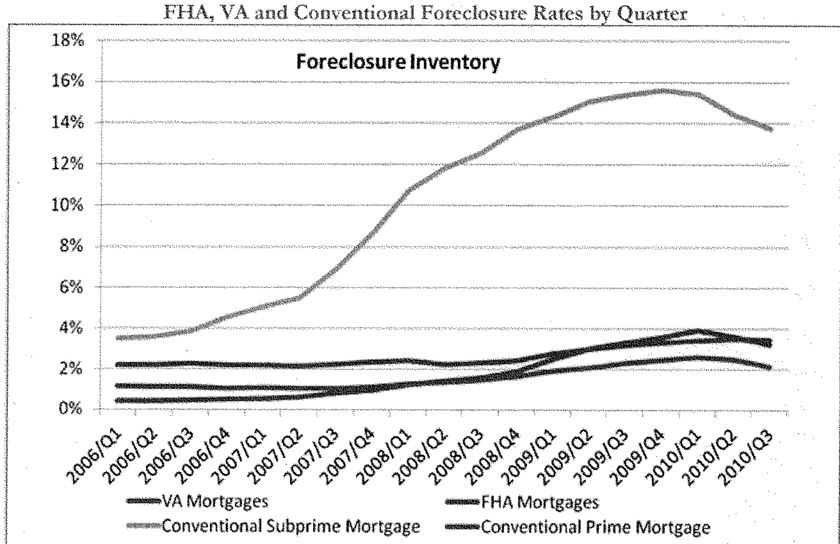
[11] CRS Report R40937, *The Federal Housing Administration (FHA) and Risky Lending*, coordinated by Darryl E. Getter.

prudent practices, has not suffered the devastating losses of other institutions. FHA's total capital resources are more than $33 billion, and FHA is outpacing expectations for rebuilding the required excess reserves.

FHA loans are performing better than ever even under these difficult times. Loans originated in FY10 are the highest quality FHA book-of-business on record.[12] The current average credit score for FHA borrowers continues to climb and is now at 700. FHA's seriously delinquent rate continues to decline, and FHA's foreclosure rate is lower than even prime convention loans. (See chart A).

Chart A

FHA, VA and Conventional Foreclosure Rates by Quarter



Source: Data from the Mortgage Bankers, Quarterly Survey of Delinquency and Foreclosure

[12] Testimony of Shaun Donovan before the Senate Appropriations Subcommittee on Transportation, Housing and Urban Development, April 7, 2011.

FHA Into the Future

FHA is performing exactly the role it was designed to do. It is filling the gap when the private market is not engaged in the market. Already, we have started to see FHA's market share drop as a tentative private investment considers returning to mortgage markets. According to FHA, applications are down nearly 40% in the last month, and more than 35% over the last year[13]. (Chart B)

It can be argued that FHA's market share is a good indicator of the state of housing markets. As is shown in the chart, when FHA was at 3 percent of the market, it should have been a warning sign that we were in a troubled mortgage market, with abusive lenders wooing homebuyers away from safer, stable mortgage products. When FHA was such a huge portion of the market, it was clear that the private market had yet to rebound. Historically, FHA's market share has hovered between 10 and 15 percent of the market. We believe this is an appropriate share for the FHA program. We look forward to FHA's continued decline, as private lenders step up to meet the needs of American homebuyers.

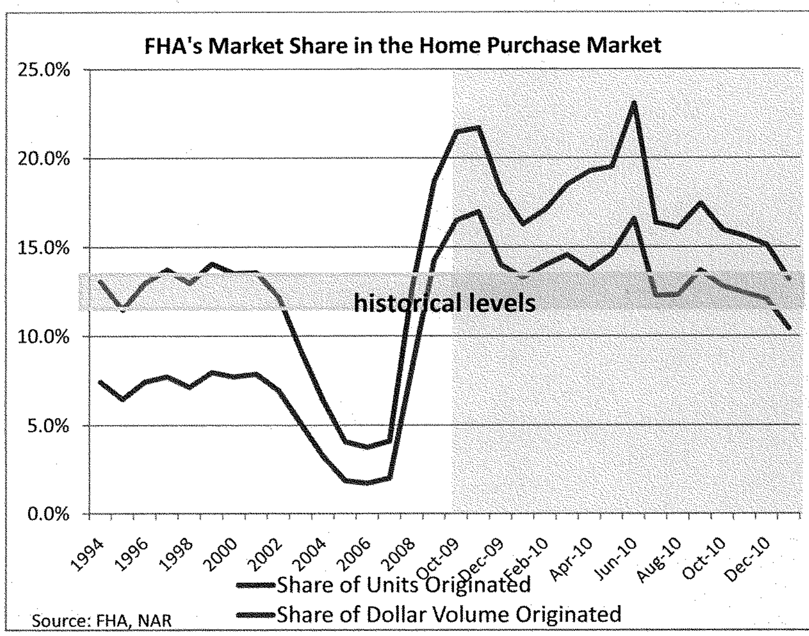
However, this decline must be allowed to happen naturally, as confidence in mortgage markets return, and private investment can provide for the needs of all qualified borrowers. Although this chart shows FHA market-share appearing to be returning to historic levels, we aren't out of the woods yet. Our most recent research found that nearly 33% of the market today is composed of

[13] Department of Housing and Urban Development, *FHA Single Family Outlook*, Monthly Comparisons, March 2011.

cash buyers, a great number of whom are investors rather than families looking to buy a home. The current market conditions are not healthy for American homebuyers, homeowners or real estate markets. We welcome a return to a stabilized market, with access to safe, affordable mortgage credit for American families.

Chart B

FHA's Market Share



The Association urges Congress to exercise caution before considering proposals that may have a profound adverse impact on our economic recovery and diminish programs that serve such a critical role to our nation's families.

Downpayment Requirement

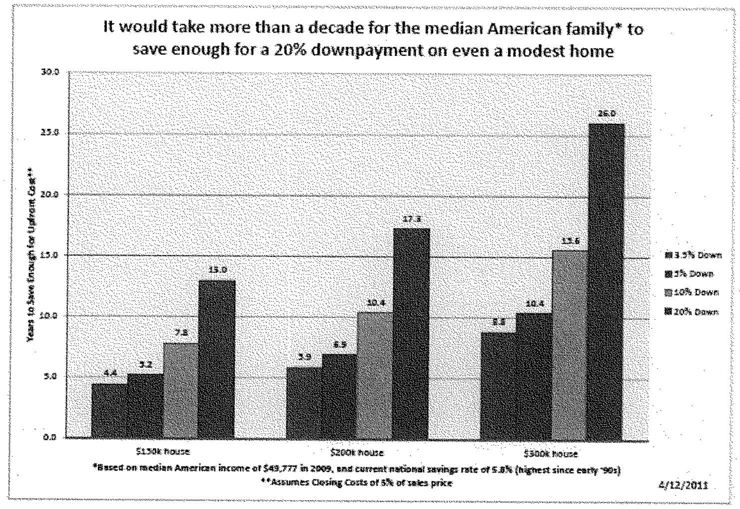
As it was when it was created, FHA remains a leader in providing safe low-downpayment to responsible, qualified borrowers. FHA's current downpayment requirement is 3.5 percent for borrowers with good credit. For more risky borrowers, FHA's downpayment requirement can be as high as 10 percent. Proposals to further increase FHA downpayment requirements are unwarranted and will not serve the purpose that proponents seek.

First of all, increasing FHA's downpayment will not add a penny to FHA's reserves. The reserves can only be increased by collecting premiums, and rising home prices. Increasing down payments does not put any additional money into reserves, it simply reduces the amount of the mortgage.

Second, while a higher downpayment requirement would increase an individual borrower's investment in the home, such an increase will disenfranchise many of the borrowers that the FHA has successfully served throughout its history, and for others could deplete their cash reserves for home and other emergencies. Closing costs average 3-5 percent of the cost of a home. Those costs combined with the current 3.5 percent downpayment requirement are sufficient to insure a borrower's commitment to homeownership, and already represent a significant financial commitment. Requiring a larger downpayment will make homeownership out of reach for many families and for others could deplete their cash reserves for home and other emergencies. According to our estimates based on very conservative assumptions, it would take the average American family, acting frugally, nearly 7 years to save for a 5 percent downpayment on a $200,000 home, and more than 10 years to save 10 percent down. (See chart C)

Chart C

Number of Years Needed to Save Required Downpayments, by Home Price and Downpayment



Source: National Association of REALTORS®

For example, when purchasing a modest $200,000 home with a 10 percent downpayment, the average total upfront cash investment (downpayment, closing costs and prepays) is $30,741. Given that the median income in the United States is $52,029, this up-front investment, even at the current national savings rate which is at a ten year high, would take the average family 10.4 years to accrue. A 20 percent downpayment on the same home would require 17.3 years of saving for this same family. For younger families preparing to settle down, have children and purchase their first home, the savings rate is likely to be much lower. Given the very conservative assumptions inherent in our calculations, it is apparent that increasing downpayment requirements will create a substantial burden for all American homebuyers and especially younger families.

This increased burden comes with only marginal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default, but can strip homebuyers of their savings and increases the number of borrowers who would be ineligible for homeownership.

A recent study showed that:

- Increasing a downpayment requirement from 5 percent to 10 percent reduces default rates by only 2/10ths of one percent, but could disenfranchise more than 8 percent of homebuyers.
- Increasing the downpayment requirement from 5 percent to 20 percent would reduce default rates by only 6/10ths of one percent, but would disenfranchise over 20 percent of homebuyers.[14]
- For FHA, increasing the downpayment requirement from 3.5 percent to 5 percent would disenfranchise more than 300,000 responsible homebuyers. [15]

If there is one lesson to be learned from the recent housing crisis, it is that the key to minimizing foreclosures and defaults is sound and careful underwriting and NOT downpayments. This is easily demonstrated by current foreclosure reports. FHA loans (with 3.5 percent downpayments) and VA loans (with zero downpayments) have a lower foreclosure ratio than prime conventional mortgages (Chart A). Why? These loans have solid, verified underwriting requirements. These loans were not

[14] Study done by the Community Mortgage Banking Project, "Study of 33 Million Home Loans Shows that Quality Underwriting Standards Reduce Default More than mandatory Down Payments."
[15] HUD Testimony, **before the House Financial Services Subcommittee on Housing and Community Opportunity, March 11, 2010**

made unless the borrower has documented their ability to repay the fully amortizing rate on the loan. In summary, increasing downpayments will slow our nation's recovery, disenfranchise potential homebuyers, and change the very fabric of the American dream.

Loan Limits

NAR strongly supports making permanent the FHA mortgage loan limits that are currently in effect. FHA has always played a critical role in providing mortgage liquidity and has continued to do so as private financing has dried up in recent years. Many argue that the higher loan limits help only the higher cost areas, but this is not the case. Reducing the current loan limits would reduce the availability of mortgage loans in 612 counties in 40 states plus the District of Columbia. The resulting average reduction in limits would be more than $50,000. This decline would have a dramatic impact on liquidity in these markets, and could halt the housing recovery.

In addition, such a move could result in a greater risk to the stability of the FHA program since higher balance FHA loans perform better than lower balance ones. According to the FY 2009 audit, "FHA experience indicates that larger houses tend to perform better compared with smaller houses in the same geographical area, all else being equal."[16] So despite arguments that FHA higher limits put taxpayers at risk, these loans actually add strength to the program, and reduce risk to the fund.

Others argue that high FHA loan limits restricts private market activity. We strongly dispute this argument. If the current limits were restricting the development or resurgence of a private market,

[16] *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund (Excluding HECMs)for Fiscal Year 2009*, by Integrated Financial Engineering Inc., November 6, 2009, pg 45.

we would expect to see private lenders providing more new "jumbo" loans -- above $729,750 since there is certainly demand for these loans in high cost areas. But in fact, there are very few lenders willing to make these loans – even with high downpayments. When the private market returns, FHA will still have an important role in helping to serve the underserved in all parts of the country including in high cost area, just as it has from the program's very beginning when its loan limits equaled 330 percent of median home values.

Rather than reducing the current loan limits, NAR strongly urges this Subcommittee to approve H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act." This bill, introduced by Reps. Gary Miller (R-CA) and Brad Sherman (D-CA) will make the current limits for FHA and the GSEs permanent.

Conclusion

The National Association of REALTORS® believes in the importance of the FHA mortgage insurance program and believes FHA has shown tremendous leadership and strength during the current crisis. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry. We applaud FHA for continuing to serve the needs of hardworking American families who wish to purchase a home.

We urge the Administration and Congress to move cautiously before making changes to a program that has served the needs of millions of American families for nearly 80 years without needing a federal appropriation. FHA's recent audit shows that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years. We urge caution in making changes to a critical part of our nation's economic recovery, and disenfranchising American families.

NAHB
National Association
of Home Builders

Testimony of Barry Rutenberg

On Behalf of the

National Association of Home Builders

Before the

House Financial Services Subcommittee on
Insurance, Housing and Community Opportunity

Hearing on

"Legislative Proposals to Determine the Future Role of FHA, RHS, and GNMA in the Single and Multifamily Mortgage Markets"

May 25, 2011

Introduction

Chairman Biggert, Ranking Member Gutierrez and Members of the Subcommittee on Insurance, Housing and Community Opportunity, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on the future role of the Federal Housing Administration (FHA), the Rural Housing Service (RHS) and the Government National Mortgage Association (Ginnie Mae) in the single and multifamily mortgage markets. We appreciate the invitation to appear before the Subcommittee on this important issue.

My name is Barry Rutenberg; I am a home builder from Gainesville, Florida, and the 2011 First Vice Chairman of the Board of NAHB. NAHB represents over 160,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's builder members construct approximately 80 percent of all new housing in America each year, and many of our builders rely on the use of HUD's programs (largely FHA's) in order to help provide decent, safe, and affordable housing to many of our fellow citizens.

We commend the Subcommittee for its work to reform FHA, Ginnie Mae, and RHS. NAHB supports efforts to reform FHA, and we understand that this is not a simple undertaking, yet we want reform to be approached with a certain degree of caution. Reform of these programs cannot be separated from the larger discussion of reforming the complex housing finance system, including future reforms to Fannie Mae and Freddie Mac.

As we have testified in other committees, NAHB believes that a stable, effective and efficient housing finance system is critical to the housing industry's important contribution to the nation's economic performance and to the achievement of America's social goals. The federal government, through FHA and Fannie Mae/Freddie Mac, is currently accounting for nearly all the credit flowing to home buyers and rental properties. Even with this federal support, fewer mortgage products are being offered, and these loans are being underwritten on much more stringent terms. In addition, Congress and the regulators are piling on layers of regulations in an attempt to prevent a recurrence of the mortgage finance debacle that is still playing out, which in turn, creates a devastating effect on home builders and buyers alike.

This is not an arrangement that can continue indefinitely. A conversation needs to be had on how to change the unsustainable status quo of the housing finance system. NAHB has had a longstanding belief that it is crucial for the federal government to continue to provide a backstop to ensure a reliable and adequate flow of affordable housing credit. NAHB feels the federal backstop must be a permanent fixture to guarantee a consistent supply of mortgage liquidity as well as to allow rapid and effective responses to market dislocation and crises. That being said, NAHB looks forward to a continued dialogue with the members of this Subcommittee.

Importance of the Federal Housing Administration

FHA was created in 1934, at a time when America was in the midst of the Great Depression. Since then, it has had a long track record of achievement in insuring loans for over 37 million American families, many of whom would not otherwise have been able to own a home. FHA pioneered the concept of a 30 year fixed-rate mortgage and low down payments, and we still benefit from that program today. FHA maintains strong underwriting criteria to protect the tax payers and is intended to be self-funded through the upfront and annual mortgage insurance premiums that borrowers pay.

Contrary to the belief of some, FHA is not a subprime lender and has never required a federal bailout. Although the program is experiencing shortfalls in its excess reserves due to the effects of the worst economic downturn since the Great Depression, FHA remains an integral part of our nation's economic recovery. Housing has led America out of every economic downturn and can do so again if the future policies regarding housing finance reform are addressed in a manner that provides liquidity for the entire housing sector in all markets.

If we look to the dramatic increase of FHA's market share over the past few years, we can see how essential the program is for our nation's economic recovery. In 2006, the FHA's market share was at an all time low of two percent when subprime loans were at a 20 percent level. Over the last two years, FHA insured nearly 30 percent of the single family mortgage market, of which nearly 80 percent of those FHA purchase loans were to first-time home buyers. This dramatic shift is evidence that FHA is performing its mission of providing the federal backstop to ensure that every American has access to a stable mortgage product. While we still believe that the private market should be the primary source of mortgage financing, that market is extremely limited; until it returns, FHA and other federally backed programs are needed to keep our economy afloat.

FHA historically also has played an important role in the financing of multifamily rental housing, and it is especially important now during the current economic crisis. In 2008, FHA endorsed just over $2 billion in multifamily loans, which grew to $10.3 billion in 2010. HUD estimates that it will endorse another $10 billion in loans in 2011. The FHA multifamily mortgage insurance programs have enabled the construction of needed affordable rental housing units over the years, as well as contributed to the ability of property owners to rehabilitate and preserve the existing stock of affordable housing.

FHA, along with Fannie Mae and Freddie Mac, provide the majority of multifamily financing today. While it is expected that other lenders will slowly return to the market, FHA is serving one of its critical roles - providing sufficient liquidity to meet market demand for financing multifamily housing during an economic crisis.

FHA Single Family Programs

Recent Policy Changes to FHA's Single Family Underwriting

FHA has implemented a series of policy changes over the last two years, including higher mortgage insurance premiums, tighter underwriting requirements, and stricter mortgage lender enforcement, all intended to strengthen the performance of the Mutual Mortgage Insurance Fund (MMIF) and rebuild the capital reserve ratio. These changes are the most sweeping combination of reforms to credit policy, risk management, lender enforcement in FHA history.

The MMIF provides the backing for FHA's single family mortgage insurance program. HUD released the 2010 annual independent actuarial review of it's the MMIF on November 16, 2010. The actuarial review, which is required by Congress, provides an estimate of the capital reserve ratio, or the cushion that would remain after anticipated losses are taken over the term of the loans outstanding with FHA mortgage insurance.

The 2010 FHA Actuarial study found that FHA's capital ratio remained flat at 0.50 percent in 2010, slightly less than the 0.53 percent registered in 2009 and well below the 2.0 percent mandated by Congress. Despite the dip, FHA viewed the report as positive as earlier forecasts suggested that the ratio could have gone negative, in which case FHA would have needed government funding.

FHA attributes the performance to reforms over the past year that have boosted capital levels, which have been offset by a continuing drag from past business. FHA's capital resources are at the highest level ever due to the strong 2010 book of business, which has the best credit characteristics in FHA's history, and to the series of policy actions (described below) taken to strengthen the fund. Without any further policy actions, FHA's capital ratio is expected to exceed the two percent statutory requirement by 2015.

Restructuring FHA Mortgage Insurance Premiums (MIP)

FHA implemented a three-stage process to restructure its mortgage insurance premiums. The first stage became effective in April 2010, when FHA increased the upfront MIP on single family loans by 50 basis points from 1.75 to 2.25 percent.

The second stage occurred in September 2010 shortly after enactment of H.R. 5981, which gave FHA the authority to raise the maximum allowable annual mortgage insurance premium. The new law permits FHA to increase the annual MIP to 1.50 percent, from the previous 0.50 percent for mortgages with a loan-to-value ratio (LTV) equal to or less than 95 percent. For mortgages with a LTV greater than 95 percent, the FHA is authorized to increase the annual MIP to 1.55 percent (previously 0.55 percent).

FHA promptly moved to increase the annual premium, but correspondingly lowered the upfront premium. Effective, October 4, 2010, the FHA upfront MIP was reduced to one percent. The annual MIP was increased to 0.85 percent for loans with LTVs of 95 percent or lower and to 0.90 percent for loans with LTVs exceeding 95 percent.

The third, and most recent stage, in the process, occurred in February 2011. FHA announced in Mortgagee Letter 2011-10 that it would again raise the annual premium by another .25 percent for loans with case numbers assigned on or after April 18, 2011.

Updating Credit Score/Downpayment Guidelines

FHA published changes to LTV and credit score requirements in September 2010. The rule sets the minimum FHA-insured single family mortgage programs credit score at 500 and creates a two-part credit score threshold. Borrowers with a credit scores of 580 and above continue to make the standard downpayment of 3.5 percent, and borrowers with credit scores between 500 and 579 are required to make a 10 percent minimum down payment.

The new credit score and downpayment requirements became effective in October 2010. These changes have produced, according to Secretary Donovan, the highest quality FHA book-of-business on record and the future looks even brighter. The average credit score on current insurance endorsements has risen to nearly 700.

Lender Oversight and Enforcement

FHA introduced policy changes and improved lender oversight and enforcement to increase the quality of FHA insured loans. In April 2010, FHA published a rule eliminating FHA approval for loan correspondents and increasing net worth requirements for lenders, thereby strengthening FHA's counterparty risk management capabilities. In addition to FHA's increased oversight and enforcement many lenders are using more stringent overlays to FHA's policies to manage credit risk.

Legislative Proposals for FHA Single Family Reforms

NAHB generally has been very supportive of FHA's changes to ensure the MMIF is sustainable to support FHA's goal to strengthen the nation's housing market to bolster the economy and protect consumers. NAHB understands FHA currently has a disproportionate share of the mortgage market and current levels are not desirable or sustainable.

The changes proposed in the Discusison Draft , including increasing the downpayment to five percent, prohibition of financing certain closing costs, potentially higher mortgage insurance premiums, and lowering mortgage limits will restrict access to FHA credit which is the only low downpayment program. NAHB has strong concerns regarding the impact of these proposed reforms and for FHA's ability to maintain its critical mission, of providing support for home buyers during this tenuous juncture in the economic recovery.

Higher Downpayments

NAHB is concerned that increasing the downpayment from 3.5 percent to five percent will create a substantial burden for all American homebuyers, especially younger buyers and those with strong credit profiles but not enough available funds to make the increased downpayment. Also adversely affected will be current homeowners looking to move up who will not be able to do so because of the reduced number of qualified borrowers.

The increased downpayment burden provides minimal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default but causes homebuyers to use more of their reserves for the downpayment. In testimony before this Subcommittee in March 2010, then-FHA Commissioner David Stevens noted that HUD research found that increasing the downpayment requirement from 3.5 percent to 5 percent, along with prohibiting the financing of the upfront MIP, would reduce FHA's volume of loan endorsements by 40 percent and disenfranchise more than 300,000 responsible homebuyers.

Sound underwriting is the key to minimizing foreclosures and defaults not downpayments. This is demonstrated by current FHA foreclosure reports on loans made to borrowers with sound credit profiles, which have significantly improved. Last week, the Mortgage Banker's Association's National Delinquency survey reported that FHA was the only product type that experienced a drop in total delinquency rate in the first quarter of 2011. This is corroborated by FHA's data on portfolio performance, which shows that the serious delinquency rate for the total portfolio at the end of Q1 2011 was 8.78 percent, which is substantially lower than the 9.44 percent rate observed one year earlier. FHA attributes this improved loan performance to the stronger 2009-2011 book of business, which now represents half of all FHA-insured loans, by number of loans.

Potential Increases to FHA Annual Mortgage Insurance Premiums

NAHB appreciates the continued focus on strengthening the FHA's risk management practices. However, we are concerned that the proposal to remove the ceiling on the annual MIP, presently at 1.50 percent, could result in a higher annual MIP. Having already implemented a three step MIP increase, FHA's recent strong performance and the forecast that the MMIF will exceed the capital reserve ratio in 2015, now is not the time to further increase insurance premiums. Increasing the insurance premiums now will put additional financial strains on homebuyers who potentially could be buying excess housing inventory.

The strong performance of recent loans made under the revised underwriting criteria makes a compelling case that more restrictive reforms are not warranted. It is critical that any reforms to FHA are carefully evaluated, in conjunction with other mortgage industry reforms, to ensure the still fragile recovery stays on track and protects the long-term value of homeownership in the U.S.

Loan Limits

NAHB supports making permanent the current loan limits for FHA and the GSEs as calculated by formulas set in the *Economic Stimulus Act of 2008*. With no Congressional action, the limits will be reduced to the limits established by the *Housing and Economic Recovery Act (HERA) of 2008* on October 1, 2011. The new limits will be calculated based on 115 percent of area median house price, down from 125 percent and the ceiling for a high-cost area will fall from $729,750 to $625,500. The floor for FHA loans would remain $271,050. To keep the FHA and GSE loan limits at the current level, NAHB strongly supports H.R. 1754, the "Preserving Equal Access to Mortgage Finance Programs Act," introduced by Reps. Gary Miller (R-CA) and Brad Sherman (D-CA).

In contrast, the legislative proposal as drafted would calculate the FHA loan limits based on 125 percent of median home price by county, with no floor and a ceiling equal to that established in HERA. NAHB has grave concerns with this proposal. Eliminating the floor for FHA loans would reduce the loan limits for a significant number of areas throughout the country, leaving large numbers of first-time home buyers without a key source of mortgage financing. While we do not know the exact data that would be used to calculate these limits, it is clear that overhauling the way that the loan limits are set will have a significant impact on the availability of FHA-insured mortgages. Counties across the country would see their loan limit reduced by tens of thousands of dollars. This would place further downward pressure on home prices.

As an example, I live in Alachua County, Florida which currently has a loan limit of $271,050. Under this proposal, NAHB estimates that the new loan limit would be about $190,000 (based on 2010 home sales price data from CoreLogic) – a decline of 30 percent.

The reduction in the loan limits would have a significant impact on the ability to use FHA-insured mortgages to purchase new homes. New homes with energy efficient features and improved construction standards generally have a higher price point, and are more likely to be priced above of the new FHA loan limits.

Chief Risk Officer

FHA hired its first Chief Risk Officer (CRO) in its 75-year history in 2009. Last summer, FHA received Congressional approval to formally establish this position and create a permanent risk management office within FHA. The Discussion Draft proposes to elevate the current FHA CRO position to Deputy Assistant Secretary for Risk Management and Regulatory Affairs within FHA to be appointed by the HUD Secretary. NAHB commends the Subcommittee for creating this position which would allow FHA to enhance its focus on financial and operational risk management and to better respond to market developments.

Required Capital Ratios for General and Special Risk Insurance Funds

Section 2 of the draft discussion bill proposes to establish capital ratios for the General Insurance and Special Risk Insurance (GI/SRI) funds. Currently, there is no statutory requirement for capital ratios for either fund. While NAHB understands that members of Congress and the Administration are focused on strengthening the risk management practices for the FHA programs (both single and multifamily), we strongly urge you not to implement capital ratios until an in-depth analysis is conducted to determine the appropriate levels and time frame in which to implement them, as well as the projected impact on the mortgage insurance premiums (MIPs) for the FHA multifamily programs. The proposed capital ratios are similar to those for the MMIF, which guarantees the FHA single family mortgages. NAHB does not believe it is appropriate to use the MMIF capital ratios for the GI/SRI fund, because the nature of the multifamily portfolio is significantly different from the single family portfolio insured under the MMIF.

NAHB believes that it is important to note that over the last 18 months, the department has instituted a new risk management protocol for the FHA multifamily mortgage insurance programs. The new protocol tightens underwriting requirements and institutes a national loan review committee. Much effort has been made to strengthen and standardize processes and procedures throughout the field offices, and there is closer scrutiny on market strength and FHA presence than before the economic crisis struck. NAHB has been actively engaged in working with the department as these requirements have been implemented.

However, it is also important to note that the implementation of the new risk management protocol did not include an increase in the MIP for any of the FHA multifamily mortgage insurance programs. The purpose of charging a MIP to borrowers of FHA-insured loans is to collect sufficient sums to insure that, in the case of defaults, the government can cover the cost of paying off its financial obligation to the lenders. The Federal Credit Reform Act (FCR) of 1990 directs government agencies to provide a realistic picture of the cost of government loans and guarantees. To comply with the FCR in determining the costs of the FHA multifamily mortgage insurance programs, HUD uses an economic model that takes into account the risks and costs of each program and has traditionally set the MIP for a specific program at a level sufficient to protect the integrity of the insurance fund without overcharging borrowers. The practice, since 2003, has been that the MIPs for the FHA Section 221(d)(4) and most other programs are set at roughly breakeven levels.

Thus, any proposal to implement a capital ratio on the GI/SRI funds could have a significant impact on MIPs. Higher MIPs will lead to higher costs for borrowers and renters who are served by the FHA multifamily programs. A key example is the Section 221(d)(4) program where a higher MIP will raise the required borrower debt service and/or equity contribution, resulting in a lower mortgage amount at a higher rate of interest. These higher costs would be passed along to the low- and moderate-income families who use the program in the form of higher rents or could result in properties not being built or rehabilitated because of the higher equity contribution required.

At this time, there are few alternative sources of financing for multifamily rental housing. FHA, Fannie Mae and Freddie Mac have provided the vast majority of financing for multifamily rental housing during this economic crisis and will continue to do so for the foreseeable future. Although we do expect some of the other sources of multifamily financing to return to the markets slowly, only projects in the strongest markets will benefit. This makes it especially critical to conduct a thorough analysis as to the appropriate level of capital ratios for the GI/SRI funds before any action is taken.

HUD Management of Rural Housing Programs

Section 13 of the discussion draft bill would transfer the functions, personnel, assets and liabilities of the Rural Housing Service (RHS) of the Department of Agriculture (USDA) to HUD. This includes all of the single and multifamily housing programs authorized under Title V of the Housing Act of 1949. The discussion draft bill would establish a Deputy Assistant Secretary for Rural Housing under the Office of Housing to administer the transferred programs.

NAHB does not support the transfer of the RHS programs to HUD. The RHS programs have financed over two million units for homeowners and over 500,000 rental units for low and moderate income households living in rural areas. In addition, the RHS has provided funding to repair thousands of single family homes, as well as rental assistance to thousands of low and moderate income persons, many of whom are elderly, and financing to provide affordable housing to migrant workers. The RHS programs are uniquely structured to address the housing credit needs of low and moderate income persons in rural areas, which are very different from those found in urban and suburban areas. We also are concerned that the transfer of the RHS programs to HUD could lead to a consolidation of the programs into existing HUD programs. If that were to occur, the network of state offices that administer the RHS single family programs would be lost, making it more difficult and more expensive for persons living in rural areas to obtain an affordable mortgage to purchase a home.

Further, if the RHS multifamily programs were consolidated into HUD programs, it would be considerably more difficult to finance small properties in rural areas because HUD does not have a program that meets this need effectively. State housing finance agencies (HFAs) with specific rural interests have taken a much larger role in financing small rural multifamily properties, largely through coupling Low Income Housing Tax Credits (LIHTCs) with RHS programs.

NAHB suggests that a more productive action would be to strengthen the RHS programs by allocating the agency sufficient funding and resources to address housing issues in rural areas. The USDA commits funding and resources to business and economic development in rural areas, and it should continue to do that for housing in rural areas. A strong commitment from

USDA to administer its housing programs in an efficient and effective manner would yield more for households residing in rural areas than transferring the programs to HUD.

Guarantee Fees for Rural Multifamily Rental Housing Loans

Section 14 of the discussion draft proposes to set guarantee fees for the Section 538 program. The Section 538 program provides affordable rental housing to low and moderate income households in rural areas. The program is often used in conjunction with the Low Income Housing Tax Credit program and, thus Section 538 housing serves many very low income households as well.

Section 14 proposes that, at the time of issuance of the guarantee, a fee equal to one percent of the principal obligations of the loan would be charged. An annual fee of 0.5 percent of the outstanding principal obligation of the loan would also be charged, and if this amount is not sufficient, the Secretary may determine a fee that would cover the program costs, as required by the Federal Credit Reform Act of 1990.

NAHB supports the Section 538 guarantee loan program and believes that the suggested fees are appropriate to ensure that the program remains available and is budget neutral.

Conclusion

Few things are more important to Americans than their homes. Whether they rent or own, Americans want to choose where they live and the type of home that best meets their needs. Rental housing is the choice for millions, from all ages and walks of life. For many others, the opportunity to own a home is the cherished ideal. Today, even though the housing market is still suffering from the effects of the worst housing market downturn since the Great Depression, Americans still believe in homeownership, which is why NAHB appreciates the key role FHA has played in keeping our housing market liquid, stable and affordable.

NAHB commends the Subcommittee for its work on the draft proposal. We understand that looking at ways to improve the housing market is not an easy task. NAHB does have some serious concerns on how to move forward that may differ from the Subcommittee. However, we would like to continue discussions on how to address the complete housing finance system, as FHA, Ginnie Mae and the GSEs are part of the larger financial system that is essential to moving our economy forward.

Thank you again for the opportunity to address you today. I look forward to any questions.

NCSHA

May 24, 2011

The Honorable Judy Biggert, Chairwoman
The Honorable Luis Gutierrez, Ranking Member
Subcommittee on Insurance, Housing, and Community Opportunity
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Biggert and Ranking Member Gutierrez,

As you consider the future role of the Federal Housing Administration (FHA), Rural Housing Service (RHS), and Government National Mortgage Association (Ginnie Mae) in the single-family and multifamily mortgage markets, the National Council of State Housing Agencies (NCSHA) urges you to support a proposal that would enhance the efforts of state Housing Finance Agencies (HFAs) to develop and preserve assisted multifamily housing by strengthening the FHA Risk-Sharing program.

This legislation would authorize Ginnie Mae to securitize any FHA Risk-Sharing multifamily loans under the same terms and conditions as if the loan were insured under the National Housing Act. This proposal would result in cost savings for the federal government and would enhance liquidity, increasing the preservation and development of much needed affordable rental housing. This proposed was approved by the House Financial Services Committee last year.

NCSHA is a national nonprofit, nonpartisan association that represents the interests of state HFAs before Congress and the Administration. NCSHA's members are the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands, along with many of their affordable housing partners.

State HFAs are most widely known for their safe and sound first-time homebuyer lending programs, which have provided a reliable source of affordable mortgage money for working families over many decades in strong and weak economies. They also provide low-cost multifamily financing to facilitate the development of affordable rental homes. HFAs administer several key federal housing programs, including tax-exempt Housing Bonds, the Low Income Housing Tax Credit (Housing Credit), HOME, vouchers, and Section 8 project-based assistance, along with various state housing programs.

HFAs sell tax-exempt housing bonds to finance mortgage loans used to develop and preserve multifamily affordable housing. The mortgage loans funded by these bonds are typically securitized and sold, freeing up funds for further affordable housing loans. The HFA Risk-Sharing program, authorized by Section 542(c) of the Housing and Community Development Act of 1992 (12 U.S.C. 1707), is one of the primary multifamily affordable housing financing tools used by state HFAs. Under the Risk-Sharing program, loans underwritten by HFAs receive full FHA mortgage insurance, just like a standard FHA-insured mortgage. In the event of a default, FHA and the HFA apportion the loss according to a Risk-Sharing agreement entered when the loan was made.

The program has been very successful and continues to be an important tool, particularly in the current liquidity crisis, when owners and developers of affordable housing are having difficulty obtaining financing. Under the Risk-Sharing program, 23 HFAs have issued more than $4 billion in bonds to finance 774 developments with more than 88,000 apartments. Program loan default rates have been very low.

Despite the very low risk involved in Risk-Sharing loans, bonds used to fund these loans are difficult to sell, because of a statutory provision that prohibits securitization of HFA Risk-Sharing loans by Ginnie Mae. Without Ginnie Mae securitization, the bonds used to fund these loans do not receive Ginnie Mae credit enhancement and are less attractive to potential bond investors. Under the legislation the Committee approved last year, Ginnie Mae would enhance the bonds by providing a guaranteed pass-through of principal and interest payments while the loan insurance is being processed, thus increasing the liquidity of the bonds.

In the current economic environment, HFAs are struggling to sell bonds. If Congress authorized Ginnie Mae to securitize Risk-Sharing loans, some experts predict that the interest rate on the underlying mortgages could be reduced by as much as 200 basis points, or two percent. This rate reduction could translate into lower rents and potential rent subsidy savings for federally assisted apartments. Recent studies indicate that in the aftermath of the housing and financial crises, the demand for affordable rental housing far exceeds supply. Improving the liquidity of HFA Risk-Sharing bonds would help address this need.

We strongly encourage you to support legislation to eliminate the prohibition of Ginnie Mae securitization of HFA Risk-Sharing loans. This legislation would amend Section 542(c) of the Housing and Community Development Act of 1992 to permit securitization and credit enhancement of the Ginnie Mae bonds, which would facilitate the sale of bonds to fund HFA loans necessary for the preservation and development of affordable housing. Further, the increased development and preservation activity facilitated by this change would in turn stimulate local economies by creating jobs and investment. The proposed change would not impact underwriting or eligibility standards and should create de minimis additional risk to the federal government.

The Congressional Budget Office (CBO) estimates that enactment of this proposal would result in $20 million in mandatory savings over ten years ($2 million annually). CBO also concluded that the new authority would enable Ginnie Mae to guarantee $500 million in new loan guarantees in the first year and about $1 billion in new loan guarantees annually in subsequent years.

The proposed language is supported by Ginnie Mae, FHA, and HUD and reflects changes that were suggested by each. This proposal was included in H.R. 4868, the Housing Preservation and Tenant Protection Act, which the House Financial Services Committee reported in 2010.

Thank you for your consideration of this proposal. Please let us know if we can provide additional information. We would welcome the opportunity to discuss this legislation with you in person.

Sincerely,

Barbara Thompson

Barbara Thompson
Executive Director, NCSHA

cc: House Financial Services Committee Chairman Spencer Bachus
House Financial Services Committee Ranking Member Barney Frank

STATEMENT OF THE NATIONAL HOUSING LAW PROJECT
Prepared by Gideon Anders, Senior Attorney

SUBMITTED TO THE SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY, HOUSE FINANCIAL SERVICES COMMITTEE ON LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS AND GNMA IN THE SINGLE-AND MULTI-FAMILY MORTGAGE MARKETS

May 25, 2011

The National Housing Law Project (NHLP) is a nonprofit organization that has represented the interests of low-income households on housing matters for over 43 years. For more than 38 of those years, our staff has represented clients applying for and living in housing financed by the Rural Housing Service (RHS) and its predecessor agency, the Farmers Home Administration. While we have had disagreements with the agency with respect its administration of various programs, we have also consistently supported the agency and its programs because of their effectiveness in delivering decent and affordable housing to rural residents.

NHLP is strongly opposed to the proposal before this Subcommittee to transfer the RHS housing programs to the Department of Housing and Urban Development (HUD). The ill conceived transfer will ultimately result in the termination of all the current RHS housing programs, depriving rural areas of effective housing programs that stimulate and improve their economies and improve rural housing conditions by serving low- and moderate-income households. HUD simply does not have the institutional interest, personnel, or financial capacity to operate the rural housing programs in a manner that RHS and its predecessors have successfully operated the programs for over 60 years. We urge that the Committee defer consideration of the proposed legislation until it has had an opportunity to confer with HUD and RHS staff and with organizations serving rural areas to fully explore and understand the dire ramifications and costs of a proposed transfer.

RHS was established to directly serve rural areas because the incidence of substandard housing in rural areas was higher than in urban areas and because financial institutions, even those assisted by the Federal Housing Administration (FHA), were not extending their services, particularly mortgage lending, to rural areas. To address rural needs, RHS was organized in a manner that enables it to deliver services directly to rural residents through a dispersed office system with specialists who are trained to deal with single and multi-family applicants and borrowers. It is a unique system that, to our knowledge, is not replicated in any federal agency other than other divisions within the Department of Agriculture.

Today, while rural areas continue to have a higher incidence of substandard housing conditions than urban areas, financial institutions, having entered the more populated rural areas, still do not serve low-income households or developers seeking to construct multi-family rental housing. RHS rental housing is practically the only decent and affordable rental housing in most rural communities.

Simply transferring and maintaining the existing RHS delivery system to HUD does not make sense because it would be extremely costly and would not accomplish any objective other than unifying two agencies that have distinct housing responsibilities. On the other hand, we expect that HUD, an agency accustomed to dealing with intermediary financial institutions and agencies, will modify the operation of the rural housing programs to fit its current office and program structure and that it will do so notwithstanding the creation of the position of a deputy assistant secretary for rural housing.

We expect that changes to the rural housing programs as a result of the transfer will be substantial and that they will have an adverse impact on the rural housing program that will lead to their termination within a very short period of time. In turn, this will unfavorably impact rural areas that are dependent on the current RHS housing programs to maintain their housing stock and improve their economic viability.

The most significant adverse impact that the transfer will have will be on the Section 502 direct single family home loan program, which has operated since 1949 and which has assisted over 2.5 million households in becoming successful homeowners. The direct loan program depends on local offices and direct contacts between applicants and borrowers and RHS staff. Local RHS offices take, review and approve all Section 502 loan applications, and approved applications are serviced by the Centralized Servicing Center (CSC), frequently with the assistance of local offices. While CSC servicing has its shortcomings, its operations are far superior to those of financial institutions participating in the RHS guaranteed loan program.

HUD does not currently operate a direct loan program and will not acquire the capacity to operate one with the transfer of RHS staff unless it establishes between 700 and 1000 field offices in rural areas in all 50 states. It is difficult to imagine that HUD, even under the most sympathetic administrations, will replicate the RHS field office structure. HUD has never dealt directly with home-loan applicants and it is not likely to do so now.

HUD also does not have a servicing center to deal with a direct loan portfolio. With one exception, HUD has never dealt directly with single family loan applicants or borrowers advising them about home loans, loan servicing options, subsidies and mechanisms for foreclosure avoidance. The only time HUD dealt with single family borrowers directly was between 1976 and 1995 when it was forced by the courts to operate an assignment program designed to help families under the FHA insured housing program avoid foreclosure. HUD's administration of the program was a disaster. It avoided accepting loan assignments at all costs because it did not have the staffing or institutional capacity to work with individual borrowers. In fact, HUD was so opposed to the assignment program that it asked Congress to terminate the program in 1995. Congress approved the request and eliminated HUD's capacity to assist borrowers who defaulted on their loans for reasons beyond their control.

HUD also does not have the computer capacity to operate a direct lending program with three related subsidy mechanisms and recapture capacity. To replicate the system that RHS has developed over 60 years of operation will be costly and cumbersome.

Applicants and borrowers under the RHS programs also have a due process appeals hearing system that operates through USDA's National Appeals Division. The appeals process was initially mandated by the courts and later by Congress because RHS and USDA have Constitutional due process obligations to their direct housing and farm borrowers. HUD does not have a similar division and is not likely to want to replicate it when RHS programs are transferred. It is simply too costly for a single housing program since it requires a field staff that travels to all 50 states to conduct appeal hearings.

Because we do not believe that HUD will replicate any of the RHS systems for making and servicing direct loans, we expect that it will terminate the direct loan program and convert it to an insured or guaranteed loan program, where loans are serviced by private financial institutions. If HUD decides to retain the subsidy mechanism for the program, it will effectively replicate the old FHA Section 235 program, which was known for its fraud and maladministration.

RHS also operates a unique self-help housing program that is dependent on local nonprofit organizations that provide technical assistance and supervision to households that are willing to spend 1500 or more hours constructing their own homes. Without the direct loan program and the RHS interest subsidies, the successful network of self help housing organizations, who have constructed over 100,000 units of affordable housing, will quickly disappear. Self-help housing has been a successful RHS program for more than 40 years. Efforts have been made to replicate the program in urban areas, but have generally not been successful because private lenders are reluctant to participate in a similar program. The transfer of the RHS programs to HUD will likely bring this sweat equity program to a close.

RHS also operates a small but effective Section 504 loan and grant program under which it assists rural homeowners to remove safety hazards from their homes or add bathrooms or kitchens when they are missing or not operating safely. The program is dependent on direct contact between RHS staff and homeowners in need of assistance. It has functioned effectively because it relies on the RHS staff that operates the Section 502 direct loan program. Without the 502 direct loan program, the Section 504 loan and grant program will be too expensive to operate either directly or indirectly through intermediaries. It will therefore likely be incorporated into HUD's block grant programs or terminated altogether.

RHS also operates two very successful rental housing programs, the Section 514-516 farm labor loan and grant programs and the Section 515 rural rental housing program. Both programs are direct loan and subsidy programs that effectively serve very-low income households residing in rural areas, with the farm labor housing program addressing the special needs of farmworkers. Most of the farmworker housing financed by RHS consists of very small developments--fewer than 4 units--located on farms whose owners need housing for their workers. In most instances, these farmers also have USDA farm loans. RHS staff has unique expertise in financing and supervising the operations of the farm labor program that HUD staff simply does not possess.

Transferring the Section 515 program to HUD also does not make sense. With the exception of the Section 202 elderly housing program and the Section 811 housing for people with disabilities, HUD does not directly finance any rental housing. It has little or no expertise in operating and maintaining a housing stock that on average has fewer than 25 units and operates in rural areas with special economic conditions. Because the RHS staff is dispersed throughout rural America, it can monitor the operation of this stock and provide assistance to its owners on an as needed basis. HUD, which operates through offices located in major metropolitan areas, will simply not provide the necessary supervision and technical assistance to small developments dispersed in small rural communities. Unless hundreds of RHS staff persons responsible for the Section 515 program are transferred to HUD, RHS expertise with respect to the operation and maintenance of these developments will be lost. Since we do not believe that hundreds of RHS' field staff will be transferred to HUD, we fear that both the 515 and 514-516 programs will be allowed to die.

RHS also operates the Section 502 guaranteed loan program, which has ballooned in the last several years to a $24 billion housing loan program. This is one program that we urge the committee to transfer to HUD. We do so because we do not believe that the program is substantially different from the FHA Section 203 program and because it does not rely on RHS' special rural knowledge or expertise to function in rural areas. At the same time, the program is consuming the time of RHS field staff to the point that it no longer has the time to properly serve the direct loan and grant programs. We strongly believe that this program should be at least removed from the RHS field offices and preferably moved altogether to HUD. Such a transfer will not have any adverse impact on RHS or the rural areas that it serves.

While RHS operates other loan and grant programs, it is not necessary to evaluate the impact that a transfer of each of these programs to HUD would have on their continuation or on rural areas. The examples we have briefly touched on are sufficient to make it clear that a transfer of the RHS housing programs to HUD will be costly and is likely to operate to the detriment of the rural housing programs and rural areas. We, therefore, urge the committee to abandon consideration of any transfer legislation. At the very least, we ask that the sub-committee defer and reconsider any transfer legislations until such time as HUD and RHS and other organizations that serve rural areas have had a chance to review and analyze this proposal for more than just several days and to comment on the full ramifications of such a transfer. Indeed, it may be wise to engage the GAO to review such a proposal and to conduct an in-depth study on whether consolidation of the RHS programs into HUD makes sense.

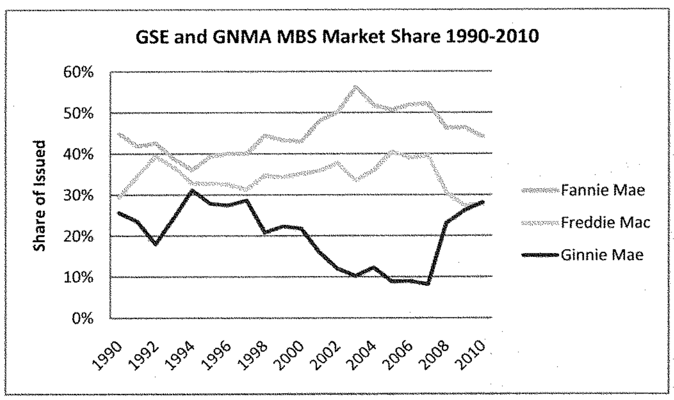
We thank you for the opportunity to submit these comments for your consideration.

SIFMA Comments on "FHA-Rural Regulatory Improvement Act of 2011"

May 24, 2011

The Securities and Financial Markets Association (SIFMA) agrees with the general principles of this legislation. It is important to review the government's current role in the housing market and to clarify its role for the long term. It is clear that the government's involvement in the housing market should be reduced and efforts should be made to encourage private sector investment in non-agency securitization. SIFMA agrees that appropriate funding of the Federal Housing Administration (FHA) insurance fund is critical to ensure the protection of taxpayers, and to ensure that FHA lending guidelines promote sustainable, responsible lending practices.

FHA and Ginnie Mae (GNMA) have grown to be key components of the US financial system. GNMA's market share of mortgage-backed securities issued has grown from below 10% to over 30% and is the second largest component of the Mortgage-Backed Securities (MBS) market behind Fannie Mae.[1] Below is a chart that demonstrates these historical trends.



According to the Department of Housing and Urban Development (HUD), in 2010 FHA loans provided funding for 20.1% of all home purchases, and importantly, 31.02% of new home purchases.[2] The Government-sponsored enterprises (GSEs) have significantly tightened underwriting and credit standards. Below are some statistics from 2010 that demonstrates that GSEs are servicing high credit borrowers.

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[1] http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Agency-MBS-Issuance-SIFMA.xls

[2] http://www.hud.gov/offices/hsg/comp/rpts/fhamktsh/fhamkt0110.pdf

2010	Fannie Mae[3]	Freddie Mac[4]
Wgt. Avg. Original LTV Ratio	68%	67%
Loans with LTV >90%	6.8%	3%
Wgt. Avg. FICO	762	758

Given the lack of private market funding for lower-down payment products, and the significant increase in credit underwriting standards for GSE products, FHA and GNMA currently provide an essential avenue to credit for home purchasers, especially first time home buyers, who do not have 20% or 30% of their home's value in cash as a down payment. FHA and GNMA also provide an avenue for borrowers with credit scores that do not reach the levels of "average" GSE loans (which are currently quite high). FHA's data points to 68% and 60% of borrowers in 2010 FY and 2009 FY, respectively, with loan-to-value (LTVs) exceeding 95%.[5] The FHA has also recently increased certain premiums, and most lenders tend to "overlay" their own standards on top of FHA's minimum criteria (such as the 580 minimum credit score guideline).

In order to reduce the role of FHA, the discussion draft would increase the down payment requirement for FHA loans to 5%, and would also prohibit the financing of closing costs. The prohibition on financing of closing costs effectively increases the amount of money a consumer must bring to the closing table. There are a number of other ways to reduce FHA/GNMA's currently outsized role in mortgage lending. The first would be the use of insurance fees and the other would be the use of credit underwriting criteria. Both should be considered viable options.

SIFMA believes it is important to note that reforms to the U.S. mortgage finance system should be done on a holistic basis. SIFMA does not believe that the system can be changed in a piece-meal fashion, because all of the various components of the mortgage finance system are interconnected – from the mortgage lender to the capital markets that provide the funding for the loans. For example, the proposed credit risk retention rules are out for comment and have not been finalized. The types of loans that will be classified as qualified financial mortgages (QRM) rules will significantly impact the availability of credit and directly impact FHA lending. In addition, the types of mortgages which will be classified as qualified mortgages (QM) is also not completed. The QRM and QM criteria need to be finalized in a coordinated fashion. Only after these rules are set will private markets be able to determine long-term business models and have some real "skin in the game."

The resolution of the GSEs, and whether or not there will be a similar role for government insurance of a broader class of MBS, is uncertain. This too will significantly impact the provision of credit to mortgage borrowers and the lending activities of large and small banks. Currently, private securitization markets remain dormant. We note that the few transactions that have been issued in the last two years have funded extremely high quality, jumbo loans. It is likely to take some time for this prime jumbo market to recover, and even longer for a market that provides a meaningful alternative for FHA/GNMA.

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[3] http://www.fanniemae.com/ir/pdf/sec/2011/q1credit_summary.pdf
[4] http://www.freddiemac.com/investors/pdffiles/investor-presentation.pdf
[5] http://portal.hud.gov/huddoc/DOC_16569.pdf, page 50

This is why whatever reform that takes place provides for sufficient time for the markets to fill in the holes.

We also note the current condition of housing markets. Given the role of FHA in home purchases and especially first-time home purchases, raising the down payment requirement on FHA loans will cause some would-be home purchases to be unable to obtain credit. This would tend to depress home purchase activity further in the near term. It is unclear to SIFMA whether or not a significant increase in credit performance of FHA loans would be engendered by raising the down payment requirement from 3.5 to 5%, and forbidding the financing of closing costs. We have not had time to do in-depth analysis of this proposal.

Therefore, we believe that any changes must be carefully considered, in terms of their costs and benefits, and their overall impact on housing markets. We look forward to providing additional comments on this proposal after our in-depth analysis has been completed.