FEDERAL HOUSING ADMINISTRATION: IMPLICATIONS OF A $1.7 BILLION TAXPAYER BAILOUT

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FEDERAL HOUSING ADMINISTRATION: IMPLICATIONS OF A $1.7 BILLION TAXPAYER BAILOUT

Tuesday, October 29, 2013

U.S. House of Representatives,
Committee on Financial Services,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Capito, Garrett, Neugebauer, McHenry, Pearce, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Barr, Cotton, Rothfus; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Clay, Lynch, Scott, Green, Cleaver, Ellison, Himes, Carney, Sewell, Foster, Kildee, Murphy, Delaney, Sinema, Beatty, and Heck.

Chairman Hensarling. The committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

This hearing is entitled, "Federal Housing Administration: Implications of a $1.7 Billion Taxpayer Bailout."

I recognize myself for 5 minutes to give an opening statement.

On February 6th, this committee held its very first hearing of the 113th Congress on the topic of the declining fiscal health of the Federal Housing Administration (FHA). We heard from witnesses that FHA was ignoring warnings about its solvency, failing to use its existing tools to price insurance appropriately, and failing to minimize losses.

Today, 8 months later, our witnesses have been proven correct. The FHA is indeed broke. It is officially bailout-broke. Twenty-nine days ago, FHA became the recipient of the latest Washington bailout, funded courtesy of hardworking taxpayers, to the tune of $1.7 billion.

On February 13th, when our witness, Commissioner Galante, came before us to discuss the state of FHA's Single-Family Insurance Fund, she testified that FHA was making changes to "accelerate the fund's recovery." Regrettably, seemingly FHA has only accelerated our national bankruptcy by accelerating the national debt clock, which can be seen on the monitors to both my left and my right.

When Commissioner Galante last appeared before us, the national debt stood at $16.5 trillion. A mere 18 months later, the national debt now stands at a staggering $17.3 trillion and counting, over $140,000 per American household, on average, and $1.7 billion of that is courtesy of the FHA bailout.

Our spending-driven national debt is the greatest existential threat that is facing our Nation today. The former Chairman of the Joint Chiefs of Staff has said that the greatest threat to our national security is our national debt. The Democratic co-chairman of the President's fiscal commission, Erskine Bowles, has said this debt is like a cancer: "It will destroy this country from within."

Just last month, the Congressional Budget Office warned us yet again that our Federal debt is unsustainable. Yet, a number of my Democratic colleagues have asked to have the debt clock removed, taken out from sight, reflecting a see-no-evil attitude. And, in fact, President Obama has said, "Don't pretend as if America is going bankrupt." I have but little doubt similar words were spoken in both Greece and Detroit.

Barely a week ago, the Congressional Budget Office (CBO) delivered more bad news, reporting that FHA has consistently misstated its projected recovery. Specifically, the CBO has said mortgages insured by FHA over the past 2 decades have had a net cost of $15 billion even though the initial estimates from FHA suggested $45 billion in profits. That is a remarkable $60 billion swing in the wrong direction—another rosy scenario dashed at an agency that, regrettably, has a history of such.

Whether it was Assistant Secretary Stevens telling us back in 2009 that FHA's financial troubles would "last a short period of time" or Secretary Donovan testifying in 2011 that the insurance fund's "prospects for the future are good," or Commissioner Galante reporting in 2012 that reforms and enforcement efforts under way are "positioning FHA well for the future," these assurances today ring a little bit hollow.

The taxpayer-funded bailout of FHA reinforces everything that many have said about FHA for some time: that it is high-risk to taxpayers; high-risk to the mortgage insurance market; and high-risk to our economy. The Government Accountability Office (GAO) underscored those points in February when it added the FHA to its list of programs considered high-risk due to their vulnerability to fraud, waste, abuse, mismanagement, or the need for transformation.

The $1.7 billion bailout of FHA also reinforces the need for the Protecting American Taxpayers and Homeowners Act, the PATH Act. The PATH Act will achieve needed objectives for the Federal Housing Administration. It will put FHA on a sound financial footing and keep it there. It clearly defines FHA's mission to ensure that the agency is serving first-time home buyers and low- to moderate-income borrowers.

The PATH Act shifts risk away from taxpayers and into the private sector by reducing FHA's footprint and making sure the industry is complementing the private sector, not competing with it. It ensures that the FHA runs its Single-Family Insurance Fund according to the basic tenets of mortgage insurance. Finally, the PATH Act mandates the insurance of the 30-year fixed-rate mortgage and retains FHA's countercyclical role.

The American people clearly want to end the destructive cycle of boom, bust, and bailout that Washington policies have helped foster. They do not want an economy laid low by unsustainable levels of debt. Regrettably, the FHA, as it operates today, exacerbates both. The FHA has gone from backstopping the market to supplanting the market. The time for FHA reform is now. We can truly wait no longer.

The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Ms. Galante, first, let me thank you for coming down to Atlanta to our home foreclosure prevention event, where we saved right on that day, as you will recall, 6,000 homes from being foreclosed upon. I really appreciate you coming down and being with us at that time.

Now, first of all, I want to say this is not a bailout. It is very easy for us to try to use that kind of language. This is a required, mandatory appropriation of nearly $1.7 billion in appropriations from the United States Treasury that is required, that is needed, and is very timely for our recovery.

Now, to the chairman's point, my facts, just to recall, the Federal Credit Reform Act of 1990 requires that at the end of each fiscal year, every government credit agency, which includes the FHA, must have sufficient reserves to cover 100 percent of anticipated future losses. The FHA's programs, like all Federal Government direct loan and loan guarantees programs, are subject to the Federal Credit Reform Act, and they can take advantage of permanent and definite authority to cover increases in cost for outstanding loans and loan guarantees. That is all this is.

This authority allows the FHA access to U.S. Treasury funds without congressional approval for any funds needed to balance its books. That is what this is. That is what is in the law. It is no kind of bailout. And I think it is very important that we be honest with the American people so they know that this is codified in the Federal Credit Reform Act of 1990.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, the chairman of the Housing and Insurance Subcommittee, Mr. Neugebauer, for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. And thank you for holding this hearing.

And I think—several points here. One is that everybody recognizes that FHA has played a valuable role in helping first-time home buyers and low-income families enter into homeownership. But also what we understand is that when these young couples purchase these homes, it helps them set down their roots and begin to raise their families, which is good for our neighborhoods and our communities. And that is the reason it is important that we have a healthy FHA. FHA plays a vital role in that area.

The problem is that FHA is not on sound financial footing, which jeopardizes its ability in the future to provide this first-time home buyer or the low-income family financing.

Now, you are going to hear today that FHA is not broke, but that is not the case. What we know is they have a negative capital ratio of 1.44 percent. They are supposed to have a capital ratio of 2 percent, and many private mortgage insurance companies have to have a capital ratio of 4 percent.

The other is that they have a negative net worth of $16.3 billion. You are going to hear that they have $48 billion in the bank. There are a lot of companies in bankruptcy that have money in the bank; they just don't have enough money to cover all of their liabilities.

And so what we need to do is pass the PATH Act. What does the PATH Act do? It begins to make sure that we have a strong and healthy FHA for the future so they can help these families. It also makes sure that the taxpayers don't have to underwrite these mortgages in the future and puts them on sound footing. It gets FHA back to its original core mission.

It is important that we have this discussion today, but what is more important is we need to know exactly where FHA is, because I don't think anybody knows. We are told, every time someone comes to tell us about FHA, that things are fine, things are getting better. We had people come in and tell us the same thing about Freddie Mac and Fannie Mae; things were fine, things were great. But that turned out not to be the case. And what this Administration has done is missed the mark on projection after projection of when this fund is going to be back into its statutory limit.

With that, Mr. Chairman, I yield back the time that I don't have.

Chairman HENSARLING. The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 2 minutes.

Mr. HIMES. Thank you, Mr. Chairman. And I welcome the witness to come before us today and talk about a very important question.

A couple of observations. One, once again, I sit down and listen to the majority talk so piously about the need for fiscal responsibility and so much concern about the debt that most of them, of course, voted last week to default upon, questioning, I think, whether we should take any protestations of responsibility and prudence coming from those who voted to default on the United States debt with, perhaps, a rather large grain of salt.

But to move on to the topic of this hearing, it is important that those who are watching this understand that when the word "bailout" is used, it is not being used terribly accurately. What is occurring here is essentially an accounting entry.

And I am not saying that this is an good thing. The FHA, like so much of the private housing industry and our banks and Fannie Mae and Freddie Mac, is paying a tremendous price for the activities of the real estate industry and the government's involvement in real estate in the years 2006 and before and after that. They are staggering out of what was the most significant dislocation we have experienced since the 1930s. So it is not shocking that, in fact, they are looking for $1.7 billion in capital.

If you believe that the real estate market is destined to take another massive downturn, you should be concerned that will never be reversed. However, the decades and generations of experience with FHA show two things.

One, this is not cash. This is not cash going to Merrill Lynch or Bank of America or any of the other financial institutions that received bailouts in 2008. This is an accounting entry. This is an accounting entry whereby FHA says, we have a call on cash from the Treasury.

Two things to be pointed out about that. One, it is an accounting entry that, if you look at the history of FHA, has always been the opposite. As for most of its existence, it has actually operated at a surplus and funded important affordable housing programs.

So, as we talk about a bailout, keep in mind that this is not cash; this is an accounting entry.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentlemen has expired.

The Chair now recognizes the gentleman from New Jersey, the chairman of the Capital Markets Subcommittee, Mr. Garrett, for 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

Thank you, Commissioner, and we appreciate you being here today, although, of course, I wish it was under happier circumstances.

But, instead, we are here in the aftermath of what is going to be the first taxpayer bailout of the FHA in its 80-year history, one which for years we were told would never happen. And just earlier this year, we were told, also, that it would be about half the size of what it is going to be in fact.

So I am certainly troubled by what this says about the FHA. I am even more troubled now, I am really angered actually, about forcing the American people once again to come and rescue yet another failed government-backed housing agency.

But on top of all that, what is even more alarming, in my opinion, is the FHA's pattern of underestimating your losses. Now, I can only see really two possible explanations for that: either FHA is really bad at assessing risk, which is basically what your core mission is; or that for years you knew what the real risks were and you were simply downplaying it each time FHA came to Congress.

In a stress test conducted earlier this year, a test, I might add, the FHA basically tried to cover up, the Federal Reserve estimated that in a severe economic downturn, the FHA would need not $1.7 billion but $115 billion. And while we can't predict whether this will happen or not, it is clear the FHA does pose an enormous potential liability for taxpayers.

One of the most important steps we as Congress could take would be to refocus FHA on its core mission of helping low- to moderate-income borrowers and first-time home buyers, and we do that with the PATH Act. How many times do we have to be burned before we learn that government guarantees don't make markets safer; they make them more dangerous?

If you can't actually get someone at FHA to admit that this is a bailout, to use that forbidden word here in this town—it is only $1.7 billion, and I guess in some people's mind that is just pocket change. And on top of all this, we are supposed to believe that this is the only bailout that FHA is ever going to need. Of course, the Federal Reserve doesn't believe that, and neither do I.

I yield back.

Chairman HENSARLING. The Chair now recognizes Ranking Member Waters for 4 minutes.

Ms. WATERS. Thank you, Mr. Chairman.

Commissioner Galante, I am very pleased you have appeared before this committee today. I would like to applaud your work in managing the Federal Housing Administration, which has provided an affordable pathway to homeownership for hundreds of thousands of first-time and low-income home buyers.

During the worst of the 2008 crisis, when the private sector virtually left the market, the Federal Housing Administration stepped up and provided the liquidity that kept our struggling housing market afloat. This is the countercyclical role of FHA as it has been throughout the course of its nearly 80-year history.

Despite corrective action taken in recent years, the severity of the financial crisis weakened the help of FHA's Mutual Mortgage Insurance Fund. Recently, FHA announced a number of changes designed to shore up its finances. Since that time, FHA has raised premiums on multiple occasions, strengthened downpayment and credit requirements, enhanced underwriting, and increased enforcement measures. In addition, FHA recently issued mortgagee letters for the Home Equity Conversion Mortgage program to help stabilize the segment of FHA's business which has accounted for the majority of FHA's losses.

As a result of these reforms, FHA's last two books for business, 2011 through 2012, have been the strongest in the Administration's history. Moreover, the 2013 book of business is estimated to continue that trend.

Nevertheless, on September 30, 2013, FHA was required to take a mandatory appropriation of approximately $1.7 billion. Although this one-time transfer of funds from the Treasury is legally necessary, it is important to note that FHA is far from bankrupt. In fact, the FHA holds over $48 billion in cash on hand, and the agency continues to generate revenue.

This mandatory appropriation is only required because FHA is bound by law to hold the revenue necessary to pay any potential claims over the next 30 years without taking into account future business. Moreover, the calculation used to determine whether a mandatory appropriation is required is completely outdated, based on assumptions about loan performance and recoveries made in December 2012. The number does not incorporate recent performance improvements or current economic factors.

These significant changes are likely to have improved the underlying financial health of the Mutual Mortgage Insurance Fund. For instance, expectations of home price appreciation have improved significantly, and, in conjunction with rising home prices, FHA policy changes have boosted recoveries on foreclosures. HUD has implemented measures including a 10-basis-point guarantee fee hike earlier this year and more aggressive pursuit of put-backs on delinquent loans to shore up the Mutual Mortgage Insurance Fund.

Higher interest rates are likely to reflect positively on the fund as existing borrowers prepay more slowly and pay mortgage insurance premiums for longer periods. As a result, this accounting transfer does not reflect an up-to-date view of the Mutual Mortgage Insurance Fund's performance, its long-term fiscal health, or its current cash position.

Above all, we must strive to have a healthy, viable FHA that continues to facilitate homeownership for first-time and low-income home buyers while standing ready in the unfortunate event of another housing downturn.

I look forward to your testimony today.

I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, the Chair of our Financial Institutions Subcommittee, Ms. Capito, for 1 minute.

Mrs. CAPITO. Thank you, Mr. Chairman.

And I want to thank our witness for being here with us today, and thank you for your service in the housing industry.

I am very concerned about the bailout of $1.7 billion. I have been on the Housing Subcommittee for many years, and I have sat through the testimony of witness after witness saying that we would never reach this point. Even when red flags were raised that we were dipping below the 2 percent MMIF ratio, under questioning we were assured that with the housing market improving, the decrease in capital reserves, this would return to normal levels and we would never need a bailout. Yet, here we are.

So I would say $1.7 billion may be an accounting move, but $1.7 billion, in my book, is $1.7 billion. And if we were told this would never happen, the question is, how did we get here?

We would have been here last year had they not made an adjustment, and I would like to have you speak to that in your testimony. And so, here we are again this year.

I yield back the time I do not have.

Chairman HENSARLING. The Chair now recognizes the gentlelady from Ohio, Ms. Beatty, for 2 minutes.

Mrs. BEATTY. Thank you, Chairman Hensarling, and Ranking Member Waters.

And thank you to our witness for being here. Let me join my other colleagues in thanking you for all of the work that you have done in this industry. And I am looking forward to hearing your testimony and having the opportunity to pose a few questions.

Let me be very brief in my remarks and say, certainly, as you and our audience today can imagine, there are two sides to every story. I have noticed the overemphasis on “bailout” today, but what I have not heard is all of the good things that have happened through your industry in providing low-income and affordable housing. Also, what the portfolio looks like today, and that those dollars that are being taken from the Treasury, I have had the absence of the word “legal,” that this is a legal way to expend those dollars.

But let me say what I was most impressed with, as I looked through your testimony—and I am sure we are going to hear more about that today—is when you said the ultimate health of the portfolio is partially a function of the broader economic environment, causing me to be reminded of when the government shuts down, the default on Treasury’s obligations are threatened, and the economy performs worse, and the MMIF suffers.

So, hopefully, you will have the opportunity to tell the other side of the story and share with us the history, but more importantly, where we go from here.

Thank you, and I yield back.

Chairman HENSARLING. The gentlelady yields back.

Today, we welcome the testimony of Carol Galante, the Commissioner of the Federal Housing Administration and Assistant Secretary for Housing at the Department of Housing and Urban Development. Ms. Galante appeared on February 13th of this year, so I believe she needs no further introduction.

Without objection, Ms. Galante's written statement will be made a part of the record.

Ms. Galante, you are now recognized for your oral presentation. Thank you for being here.

STATEMENT OF THE HONORABLE CAROL J. GALANTE, COMMISSIONER, FEDERAL HOUSING ADMINISTRATION, AND ASSISTANT SECRETARY FOR HOUSING, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. GALANTE. Chairman Hensarling, and Ranking Member Waters, thank you for the opportunity to testify today on the recent mandatory appropriation to the Mutual Mortgage Insurance Fund.

First, I want to be clear that while we would have preferred to avoid the mandatory appropriation, these funds are not a bailout and they are not a failure of the FHA model. This accounting transfer is the result of a static assessment as part of the annual budget process, and it is based on September 2012 portfolio characteristics using fall 2012 economic assumptions.

This assessment determines the amount of reserves necessary to pay for up to 30 years of potential claims. Today, these assumptions are outdated, as demonstrated by the dramatic improvements in portfolio performance, including a 15 percent drop in delinquencies, a 91 percent drop in early payment defaults, a 20 percent reduction in foreclosure starts, and a 30 percent improvement in recovery rates. These improvements cannot be captured by the reestimate calculation. And right now, FHA has $48 billion in liquid assets on hand.

The housing market was crippled by the reckless practices of private actors, ultimately resulting in the worst recession this Nation has seen in over 70 years. The discussion we are having today would be very different were it not for the serious losses on legacy books from 2006 to early 2009.

HUD has testified many times about the clear and significant impacts of those years on FHA, especially seller-funded downpayments and HECM loans—programs that incurred serious projected losses because FHA lacked the authority to expeditiously make the changes necessary to prevent them. The seller-funded program accounts for $15 billion in expected losses to the fund, according to last year's independent actuarial report. And were it not for HECM losses, our capital reserve would have been positive by almost $3.5 billion.

Throughout the crisis, FHA has played its dual role of ensuring access to credit while providing countercyclical support to the market, just as it was intended to do. And since 2009, this Administration has taken aggressive steps to ensure the fiscal soundness of FHA. We have raised premiums 5 times, reversed the premium cancellation policy, tightened credit requirements, and made unprecedented efforts on enforcement actions.

Many of these actions were made possible because of the support of Congress. I would especially like to thank Representatives Heck and Fitzpatrick for their work on the Reverse Mortgage Stabilization Act, making HECM safer for borrowers and taxpayers alike.

To be clear, while these changes cannot erase the adverse impacts of the past origination practices or the considerable strain the recession placed on the fund, they are ensuring that future books are much stronger. We are on the right track. New books of business continue to perform well, and just 2 weeks ago the Congressional Budget Office clearly noted the significant profitability of the 2010 through 2012 portfolio.

In addition to focusing on ensuring strong new books, we have executed on our commitment to reduce losses on past books, keeping families in their homes when possible, while protecting the fund. Improvements to our loss-mitigation waterfall, settlements with lenders, and expanded use of REO alternative programs are directly responsible for significant portfolio improvements I mentioned earlier. We estimate that the improvement and recovery rates alone are worth no less than $5 billion, far exceeding the amount of the mandatory appropriation.

Actions we have taken since the peak of the crisis also had the effect of reducing FHA's footprint. Endorsements have declined 27 percent since their peak in 2009.

No one is more concerned than I am with ensuring FHA continues on a trajectory toward rebuilding our capital reserve. To be successful in the future, FHA needs the right tools and your support. Indemnification authority for all our lenders and improved authority to terminate origination and underwriting approval will allow us to better identify risks and avoid unnecessary losses. Authority when the fund is at risk to quickly revise requirements via mortgagee letter while rulemaking is under way will improve FHA's ability to respond to new risks or urgent needs. Giving FHA more control over its resources both administratively and legislatively, such as use of the FIRREA wage scale or procurement flexibility, would also help.

I look forward to working with Congress to give FHA the additional tools it needs to better protect the housing market against another crisis and to make the dream of homeownership a reality for generations to come.

Mr. Chairman, thank you for this opportunity, and I am happy to answer questions.

[The prepared statement of Commissioner Galante can be found on page 52 of the appendix.]

Chairman HENSARLING. I thank you, Ms. Galante.

The Chair recognizes himself for 5 minutes for questions.

Ms. Galante, I ascribe no malevolent intent to you or your predecessors. I have no doubt that you and your staff work very hard. But in listening to your testimony, I am reminded of that famous line from a Marx Brothers film, "Who are you going to believe, me or your own eyes?"

And so what I hear from you is, frankly, what I have heard from you and your predecessor and the Secretary for many years, that all is well. And what I see with my own eyes is a Congressional Budget Office report that shows a $60 billion swing from what was supposed to be a $15 billion savings instead—a $45 billion savings has instead turned into a $15 billion cost. What I see with my own eyes is a GAO report—congratulations, FHA has now been added to the high-risk series. What I see with my own eyes is your letter, dated September 27th.

I notice that you and many of my colleagues on the other side of the aisle use the phrase "required, mandatory appropriation." That might be the phrase in Washington. The phrase on Main Street is "bailout." And what I have known is either you, your predecessor, or the Secretary have been so wrong for so long, whether it had to do with the value of the MMIF, whether it had to do with your capital ratios, whether it had to do with the need for a bailout, and then when you finally acknowledged you needed one, it turned out to be almost twice the size.

So, with all due respect, Ms. Galante, why is the testimony credible today?

And I particularly find it quite poignant that in your written testimony, one of the last lines you have is, "FHA continues to be a reliable steward of taxpayer dollars."

What is different today than all that we have heard for the last 4 years of this Administration?

Ms. GALANTE. Mr. Chairman, let me be clear. If you look at the testimony chart on page 2, which is based on the CBO report that just came out a couple of weeks ago, what we did was we added to that chart the 2013 receipts. And we broke down this chart to show you the changes in the economic value of the fund by year based on the actuarial reports, based on the budget reestimates.

This happens every year. There is a—

Chairman HENSARLING. That is kind of the point, Ms. Galante, because we have seen these charts before. We have seen them for 4 years, and for 4 years, they have been wrong.

So, again, what is different today? Why should this committee believe the testimony today, when it hasn't been credible for 4 years running?

Ms. GALANTE. Again, Mr. Chairman, since I have been here, since the Secretary has been here, what we have reported on are the results of an independent actuary, the results of annual budget reestimates that are done as part of the Administration's budget.

And the point I want to make here is that in the years in which this country was hit by the worst recession in 70 years, our portfolio took a significant hit.

Chairman HENSARLING. And I understand that, Ms.—

Ms. GALANTE. There is no doubt about that.

Chairman HENSARLING. —Galante. But, again, the housing crash came in 2007. It is almost 2014.

You would acknowledge that for the entire time this Administration has been in office, that FHA has failed to meet its legal standard of maintaining a 2 percent capital ratio, correct?

Ms. GALANTE. We have been under the 2 percent.

Chairman HENSARLING. Even though the law says "shall," not "may," not "might," not "could," but "shall."

Given that previous predictions, again, have proven so wrong for so long—for 4 years running, you have been in violation of the law—has anybody in your agency been held accountable for this?

Has anybody been fired? Has anybody been reassigned? Has anybody had a reprimand? What is the level of accountability at FHA for these actions?

Ms. GALANTE. Mr. Chairman, the 2 percent capital ratio is a requirement. We have worked very hard over these 4 years, as I have talked about, increasing premiums, changing policies, changing credit standards, to work our way past—

Chairman HENSARLING. But did you fully utilize those tools to bring your capital ratio up to 2 percent? So maybe the trend line could have been in the right direction, but didn't have you tools available to you that you could have used further?

Ms. GALANTE. Let's be clear. We didn't even have the ability to raise premiums until 2010. We had to come back to Congress to get the authority to increase premiums. So we have used our—

Chairman HENSARLING. My time has expired. So was anybody held accountable, yes or no?

My time has expired. The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Ms. Galante, again, I appreciate your being here today. And I appreciate the fact that FHA has been successful in its mission. I appreciate all of the changes that have been made. But I appreciate, more than anything else, that FHA was there for the citizens of this country who needed them when nobody else was.

And so, would you go over with us what you cited in your testimony about the success and the improvements of FHA?

Ms. GALANTE. Certainly.

As I mentioned in my testimony, we have focused on tightening the credit box so future loans that we insure are the best that they can be. We have increased costs on borrowers significantly. And, in fact, there is some concern that is restricting access to credit moving forward. But we have been balancing that with ensuring that the fund is rebuilt and the capital reserves are rebuilt as quickly as possible given economic circumstances.

The last thing I would—

Ms. WATERS. What have those actions resulted in? What kind of success have those actions resulted in?

Ms. GALANTE. The biggest success is, this past year, we have spent significant effort on the existing portfolio and reworking the loss-mitigation waterfall to enable more people to stay in their home. We have done alternative disposition of our REO assets that have significantly improved—the percentage is 30 percent improvement in our recovery rate on our defaulted loans. That is a success.

Ms. WATERS. That certainly is.

And would you one more time explain for the chairman of this committee, who does not seem to understand, the 2 percent requirement and why you had to get that appropriation and the fact that FHA is not broke? Would you explain that so the committee understands that very well?

Ms. GALANTE. Yes. Let me make two points.

First of all, the requirements for the mandatory appropriation, where we had a budget reestimate to pay for 30 years' worth of potential claims, we were just a little bit short of that total requirement.

And to get to the point of what is the difference between the 1.7, this is a static estimate. The 22.4 requirement on the reestimate was static; it doesn't change. The only thing that makes a difference during this fiscal year of whether we were going to meet that reestimate was how much revenue we were bringing into the FHA in 2013. And we brought in $17 billion worth of revenue. It was just shy of what was needed to fill that reserve up.

Ms. WATERS. We may not have time to discuss it today, but I have always been concerned about the 30-year requirement. And it seems to me, if we were doing our work here in the Congress, we would take a look at that and try and understand whether or not that makes good sense, whether or not it is realistic, or whether or not we should update and take a look at that.

Again, would you explain to this committee how it is you have to have, or you are mandated to take an appropriation when you have, what, $48 billion?

Ms. GALANTE. That is correct. This is required as part of the Federal budgeting process and as part of Federal credit reform so that—think about this. You have to take money from your savings account to put it in your checking account so that it is there, available to pay your 5-year-old child's college tuition 10 or 15 years down the road. That is what we are required to do.

Ms. WATERS. Let me just say that my chairman here, Mr. Hensarling, has talked about the need for somebody to be fired. He questioned you about who you have fired, who your predecessors fired. And let me just say to you that his eyes, as he described, are seeing things; my eyes see things differently.

And I think if anybody needs to be brought to task, it is perhaps the Congress of the United States and this committee for not doing its oversight responsibility in updating, first of all, the 30-year requirement and having an appreciation for how you have provided a safety net when everybody else refused to participate in the housing market.

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

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, the chairman of the Housing and Insurance Subcommittee, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to make a couple of points.

One is I agree with the ranking member, in the sense that we need to change this antiquated accounting system that we are using at FHA. And I would ask her to join me in supporting the PATH Act, where we go to GAAP accounting, which is what the rest of the world has to use. And those numbers would be more negative, in the sense that if you used GAAP accounting, it is estimated that FHA would have a negative $26 billion net worth.

Ms. Galante, I want to point you up there to the chart, and it is maybe hard to read, but the dotted lines are previous years where FHA has predicted what their progress would be. And, as you can see, the red line at the top is at the 2 percent mandatory requirement for reserve, and the blue line, as you can see, is the actual reserve ratio.

So the question is—and back to, I think, what Chairman Hensarling was saying—is why would we sit here—as we listen to your testimony today, we have heard similar testimony in previous years where the projections are as we see up there, but yet what the actual results are are far from that. I think it is like going to a doctor and your health continues to deteriorate but the doctor tells you you are just fine. Would you continue to go to a doctor who told you you were just fine if your health continued to deteriorate?

Ms. GALANTE. Let me just answer that by saying, the actuarial projections are based on economic conditions. If economic conditions worsen, if house prices don't go up as much as they project, things like that—this recession lasted longer, was deeper, was more harmful for families than the independent actuary—these aren't our estimates—than the independent actuary projected, in the first actuary, for example.

So, yes, these numbers are affected by external events, the external events of the shutdown, for example, and those kinds of activities affect the economy, affected the economy by $24 billion, according to Standard & Poor's. If it has an effect on the housing market moving forward, that will affect FHA negatively. We are very subject to the overall economic conditions—

Mr. NEUGEBAUER. Yes, but—

Ms. GALANTE. —and how well the portfolio performs.

Mr. NEUGEBAUER. —the bottom line, Ms. Galante, is you are not currently in compliance with the 2 percent reserve. Is that correct?

Ms. GALANTE. That is correct, but, again—

Mr. NEUGEBAUER. Yes.

Ms. GALANTE. —this is—the accountability for that—

Mr. NEUGEBAUER. That was a yes-or-no question. Thank you.

So, as the chairman said, when you look at the National Housing Act, it states that the FHA shall—not may or could or should—at all times maintain a 2 percent capital ratio. So, in effect, the FHA is not in compliance with the law. Is that correct?

Ms. GALANTE. That has been reported for the—

Mr. NEUGEBAUER. No—

Ms. GALANTE. —number of years. In our financial statements—

Mr. NEUGEBAUER. —it has been reported.

Ms. GALANTE. —we report that compliance.

Mr. NEUGEBAUER. What is your position? Do you believe that you are in compliance with the law?

Ms. GALANTE. Again, it is reported that we are not in compliance with that particular aspect.

Mr. NEUGEBAUER. It has been reported, but you are the Director of FHA, so I just want you to tell me "yes" or "no," yes, I am in compliance, or, no, I am not in compliance with the law.

Ms. GALANTE. Again, I think I have answered that question. According to—

Mr. NEUGEBAUER. I didn't understand the response, so—

Ms. GALANTE. As a compliance item in our audit, it is reported.

Mr. NEUGEBAUER. It is a yes-or-no question. Yes, you are in compliance, or no, you are not.

Ms. GALANTE. Again, our report says we are not in compliance with that.

Mr. NEUGEBAUER. Okay. Thank you.

And so I think the question is, then, if you are not in compliance and your projections have not materialized, are you doing the right things to get that reserve ratio back to where you are not in violation of the law?

Ms. GALANTE. So—

Mr. NEUGEBAUER. Now, you are doing some things, but the question is—if you were a private company, you wouldn't even be allowed to continue doing business, because in many States that regulate private mortgage—or mortgage insurance companies, once they get below a certain level, they aren't allowed to continue to write insurance.

And so, what actions—and how can we hold you accountable to getting that ratio back so that we are in compliance with the law?

Ms. GALANTE. We have taken very aggressive action over these past 5 years. And—we can repeat them again. But we have more than doubled our mortgage insurance premiums, to the point where I think anybody would see that continuing to increase the mortgage insurance premiums would have a difficult time for new borrowers essentially paying for these legacy loans of the past.

We have increased those premiums to the amount that we believe we can without totally destroying access to credit in this country. So, we have been taking very aggressive action.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlewoman from New York, Ms. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you. Thank you, Mr. Chairman, and thank you, Ranking Member Waters, for this hearing.

And as my fellow New Yorker, former Senator Patrick Moynihan, used to say, everyone is entitled to their own opinion but not their own facts. And the facts are that the FHA has succeeded in continuing to meet its mission, to strengthen the insurance fund, and to reduce its role as the housing market continues to recover. So I want to compliment you, Commissioner, and your staff for your hard work.

I want to point out that there were expected losses associated with the worst years of the housing crisis, and the crisis hit housing harder than any other sector in our economy. And while a $1.68 billion mandatory appropriation was recently requested by FHA to ensure that at the end of Fiscal Year 2013, the Mutual Mortgage Insurance Fund has sufficient funds in the capital reserve account to pay for all of its expected future losses, these accounting projections are based on data from the fall of 2012.

And this request is not a bailout, as the Commissioner pointed out, and is not a reflection of the FHA's ability to pay claims on outstanding loans insured by the insurance fund. Rather, the mandatory appropriation is a reflection of old information, not the realtime performance of the fund. And the improvements and recoveries alone are worth at least $5 billion, a value that is much higher than the required transfer of $1.7 billion.

Now, the chairman wanted to know if anybody had been fired. Well, they weren't fired, but they were certainly furloughed. And despite the government shutdown, which forced the FHA to operate with a skeleton staff of 64 people out of a total of 3,000, they continued to perform services for the American public. And this was, of course, in addition to the sequester cuts, which resulted in 100 percent of FHA employees taking a mandatory cut that—and, I would say, an undeserved pay cut, compliments to the majority party.

And, in any event, I would like to ask you, Commissioner, about the role, the very positive role, that the ranking member pointed out of the countercyclical role that FHA plays in times of crisis.

Now, the charts I looked at is you were this part, and then because no one else would do it you went up and helped the American people.

And I would like to put in the record a statement by Mark Zandi, an independent economist from Moody's—

Chairman HENSARLING. Without objection, it is so ordered.

Mrs. MALONEY. —which noted that the role of the FHA—absent the role of the FHA, according to Moody's, the average price of a home would have declined an additional 25 percent.

So I think I would like to thank the FHA for helping to preserve housing prices and for coming in and meeting a role when the private sector wasn't there and now retreating as others are willing to come forward.

Could you elaborate on the countercyclical role that FHA plays in times of crisis, such as the one we just lived through?

Ms. GALANTE. Yes. Thank you.

The FHA has helped, since the start of this Administration, 7 million people become homeowners. The FHA has been particularly important to African-American and Hispanic home buyers and people with credit scores, for example, that are lower than the norm or lower than the private market on its own would help. So those credit scores, or those populations had a much deeper challenge getting financing during this recession, and the FHA was there for those borrowers. It was there for a broader group of borrowers who in good times don't need the FHA.

Mrs. MALONEY. So I would say that FHA continues to accomplish its mission, when it was the same mission that it had in 1934, which is facilitating access to sustainable mortgage finance, particularly for underserved minority communities and borrowers, and being a critical countercyclical force on mortgage lending during times of crisis that we just lived through.

Now, if the FHA goes ahead—excuse me, if the FHFA goes ahead with its plan to lower the loan limit for Fannie and Freddie on its own, without even considering any input from Congress, will that force FHA to lower its loan limit, as well, to maintain consistency?

Ms. GALANTE. Let me just say that, first of all, FHA's loan limits will change on January 1st because the special legislation for FHA higher loan limits expires on January 1st of this year.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from New Jersey, the chairman of our Capital Markets and GSE Subcommittee, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Again, thank you, Mr. Chairman.

I think the phrase, "so wrong for so long," will be the takeaway from today's hearing. For so long, the FHA has come to this committee and has given us wrong information time and time again.

Now, I know the chairman started out with a Marx Brothers reference. I will start out with a familiar Einstein reference, which is, "The definition of insanity is doing the same thing over and over again and expecting different results." And I think perhaps that is what we have been hearing from the FHA and this Administration for the last number of years, coming with positive charts, promises that things are getting better. To use your own words, "We are on the right track." I believe I have heard those words or similar words year after year after year after year after year from this Administration. The track is getting pretty short, and now I guess it has gotten to the point where it needs a bailout—oh, I'm sorry, not a bailout but an accounting irregularity.

So, first of all, do you believe that the FHA, you and your predecessors, have been honest with Congress and the American people over the last 5 years?

Ms. GALANTE. Yes, I absolutely believe we have been honest. We have reported on independent reports, and we have tracked the portfolio performance, and we have reported on all those activities.

Mr. GARRETT. With regard to those tracks, one of them was your estimates of the worst-case scenario. What are your estimates, your agency's estimates of the worst-case scenario as far as losses?

Ms. GALANTE. I don't have those numbers in front of me, but I would say—are you talking about in the actuarial report?

Mr. GARRETT. The actuarial study, yes.

Ms. GALANTE. In the actuarial study last year, we looked at the 95th percent worst path, and I think the negative value is somewhere around $65 billion.

Mr. GARRETT. Right. But you are familiar with the Fed's study, correct?

Ms. GALANTE. I am familiar with a draft of a chart that was in an early actuarial, yes.

Mr. GARRETT. You never saw the final Fed results?

Ms. GALANTE. The only thing I ever received was a draft of a chart.

Mr. GARRETT. So if I told you that their number was not 60-something, it was 115 billion, that would be new information to you?

Ms. GALANTE. No. That was in the chart.

Mr. GARRETT. Okay. So why are they so wrong and you are so right, with their projections?

Ms. GALANTE. Again, it is not whether they are right or wrong. It is that the determination was made by the actuarial that was not an appropriate stress test. We were already doing—the actuarial was already providing 99th or 95th percentile worst potential activity, and a Fed stress test is meant for a totally different purpose.

Mr. GARRETT. It was reported in The Wall Street Journal earlier this year that a senior FHA official said that while the agency was familiar with the Fed study, they still wanted to present the results of the Fed stress to other government agencies but not to the American public.

I quote from the article: "We—this is from your agency, the FHA—just do not want the analysis to be in the actuarial review report." And, "In congressional hearings, it is quite possible that we will be required to present this information on the record, but that will be well after the actuarial review is released and the initial media coverage takes place.”

It sounds as though the information was available to this Administration, but you wanted to wait until after you came to Congress, made your presentation here, and the media covered it, to present the information. It sounds as though you were, in a positive sense, putting a spin on it, or in a worse case, trying to cover it up.

Why do you think that the American public should have any confidence after such reports come out?

Ms. GALANTE. Let me say a couple of things.

First of all, that Wall Street Journal report was reporting on a congressional oversight by Congressman Issa’s committee. That is ongoing.

I just want to say that the actuarial report is an independent report. The actuary determines what information goes in there. Stress tests aren’t even required as part of actuarial reports. In conversations between the actuary and our staff—

Mr. GARRETT. That is actually not what is reported. Emails from the FHA indicated that the FHA did not want the bleaker forecast, as they put it, included in your own report. And it was the FHA that was withholding that information, and preventing it from going into the report.

So your testimony right now contradicts what came out earlier, saying that the FHA knew that the Fed’s report was not good and was directing that your own actuaries would not take the bleaker presentation.

Ms. GALANTE. To be—

Mr. GARRETT. Is that not true?

Ms. GALANTE. —clear, Congressman, I can’t comment on what other people’s emails—

Mr. GARRETT. They work for you, do they not? Have you looked into this?

Ms. GALANTE. Just to be clear, I am not going to comment on somebody else’s email in a group of emails that have been turned over to the investigative committee.

Mr. GARRETT. Can I just ask the Chair to—I know at the end of the hearing we are able to ask for additional questions in writing to the witness—ask her, at this point, to provide information in writing after the hearing?

Chairman HENSARLING. Certainly.

Mr. GARRETT. Thank you.

Chairman HENSARLING. Without objection, it is so ordered.

The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

I just don’t understand how my colleagues on the other side—if anything, FHA should be given praise and a thank you. Because this market, this housing market, but for FHA, would have really destroyed this country.

We forget sometimes that it wasn’t this Administration, it was the prior Administration that drove us into the worst recession since the Great Depression, not this Administration. And much of that time is when they were in charge. They had the White House, they had the Senate, and they had the House. And they drove this country down to where it was. It took a new Administration to bring us to a different path, where we are now recovering.

Now, unfortunately, when we have this Great Recession, the FHA, which came into existence after the Great Depression to help preserve the market—isn't that the original reason why the FHA was created?

Ms. GALANTE. It is, yes.

Mr. MEEKS. And so now, we have the same situation. The Great Recession, since the Great Depression, so we had to depend again, as we did going back into the 1930s, on the FHA to help save this country. How did you do it? Because you have two parts, you are supposed to facilitate, access sustainable mortgage financing, particularly for underserved borrowers, and act as a stabilizing countercyclical force during times of crisis of uncertainty. We had times of crisis and uncertainty. By its very nature, therefore, a countercyclical agency that is asked to take on more volume, which you did, and more risk doing during an economic crisis, will obviously also experience cyclical ups and downs in its own financial strength. Wouldn't that be correct?

Ms. GALANTE. Yes.

Mr. MEEKS. And therefore, isn't it also the very nature of a countercyclical institution and why we need them in the first place, because that is what you were created for. You did your job, the thing that you were created for, isn't that exactly what you did?

Ms. GALANTE. Yes, sir. Thank you.

Mr. MEEKS. And let me ask this, let's just think about this: 40 percent of all first-time home buyers, 50 percent of all African-American and Latino home buyers. So if we were to do a little cost-benefit analysis, if you will, and assume for a moment, even you, this is what it wasn't—but you can assume for a moment that you are going to use the term "bailout" as my Republican friends would like to call it. Even if you use that definition, how would you rate the return on investment our Nation has benefited for having 40 million of Americans able to own their own home, and millions more benefiting from affordable, long-term, fixed mortgage rates, are the taxpayers getting a reasonable return on their investment, would you say that?

Ms. GALANTE. Yes.

Mr. MEEKS. And let me also ask, therefore, since we are moving in the right direction, and since we are seeing that we are starting to move and get past this financial crisis, we are doing certain things and the economy is picking up, now, can you just tell us what the FHA has been moving and doing certain things to increase dollars therein, the model that you have since 2009 to ensure that the FHA emerges from this worst recession since the Great Depression as a stronger, more resilient organization? Can you tell us what is happening there?

Ms. GALANTE. Yes, we have, with your help, made changes to the reverse mortgage program, and frankly, without which, we still would have been, even after all of the stress that the fund has been under, we would have been in positive territory, and not have needed a mandatory appropriation, so we are making changes to that program to ensure that going forward, it continues to help keep the FHA healthy.

And as I mentioned earlier, we have been doing everything possible to increase recovery on that legacy portfolio loans, so that, again, we are bringing in more money on those properties to the fund, to get the fund back up as quickly as possible.

We continue investigations and enforcements against lenders who brought us fraudulent loans, particularly during this crisis when a lot was coming our way, and we could use more help on that front from Congress in terms of additional authorities.

Mr. MEEKS. With my last 15 seconds, on behalf of the 40 million first-time homeowners, on behalf of the at least 50 percent of all African-American and Latino home buyers, we thank the FHA for what you do. On behalf of the American people for helping keep the market, the housing market strong, we thank you for what you do.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, the chairman of our Oversight and Investigations Subcommittee, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you for being here today and for your testimony, and this question about being a countercyclical force, you talk about legacy loans that you are dealing with now as impacting your fund balance. Now, what years are we talking about in particular?

Ms. GALANTE. If you look at the chart on page 2 of our testimony, it is very small in—

Mr. MCHENRY. What years?

Ms. GALANTE. 2001 through 2009.

Mr. MCHENRY. Okay, so at that period of time, there was a 3 percent downpayment, no minimum credit scores, and a lack of risk-based pricing, is that correct?

Ms. GALANTE. I am not trying to herd all three of those, but yes.

Mr. MCHENRY. Okay, and what is different now?

Ms. GALANTE. So what is different now—

Mr. MCHENRY. Do you still have a 3 percent downpayment requirement?

Ms. GALANTE. A 3.5 percent downpayment requirement—

Mr. MCHENRY. Okay, so that is similar.

Ms. GALANTE. —and 10 percent if you are under a 580 FICO score.

Mr. MCHENRY. Okay, but under 580. So you are making loans to those with FICO scores under 580?

Ms. GALANTE. Today, no. Let me just be clear.

Mr. MCHENRY. None?

Ms. GALANTE. Virtually none.

Mr. MCHENRY. Virtually none, or none?

Ms. GALANTE. Let me just—this is a really important point. If you look at the changes we have made in our credit policies, not just downpayments, but overall credit policies and the tightening that we have done, a large percentage, 30, 40 percent of our portfolio in the past was lower FICO band scores, and I don't believe a person is—

Mr. MCHENRY. So what is the cutoff for FICO scores?

Ms. GALANTE. Today, that is not true.

Mr. MCHENRY. My time is limited.

Ms. GALANTE. Our average FICO score today is—

Mr. MCHENRY. Not average, what is the cutoff? If I have a 550 FICO score, can I get an FHA loan, yes or no?

Ms. GALANTE. Yes, only if you meet the lender underwriting and—

Mr. MCHENRY. Yes, so why is that called subprime?

Ms. GALANTE. —compensating factors.

Mr. MCHENRY. No, I'm asking a question, and now I am following up with this question, and I would appreciate you answering it.

Ms. GALANTE. Yes.

Mr. MCHENRY. So if I have a 550 FICO score, that is considered subprime, right?

Ms. GALANTE. Again, you would be required to have a 10 percent downpayment.

Mr. MCHENRY. I understand, but I am asking a different question than you are, in fact, answering, and my time is limited, so if I have a 550 FICO score, that is subprime. It is certainly not a prime mortgage.

Ms. GALANTE. You can't just take a FICO score and say that is subprime. You have to look at the full—

Mr. MCHENRY. Under under Qualified Residential Mortgage (QRM) and the Qualified Mortgage requirements, that would not be permissible and not within the box. So let me get to the point here. If we are talking about FHA as a countercyclical force, what, in fact, we saw in the early part of the 2000s, and leading up to the crisis, was FHA following the market as—and racing to the bottom in terms of underwriting standards.

Ms. GALANTE. No, that is absolutely not correct.

Mr. MCHENRY. Pardon me?

Ms. GALANTE. That is absolutely not correct.

Mr. MCHENRY. Okay, I ask unanimous consent to offer a Washington Post editorial from July 3rd of this year, going through the very provisions that I am outlining.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. MCHENRY. Okay. So can you explain to me, in March of last year you testified before the Senate Appropriations Committee. You said, "Thanks to our efforts since taking office, I can say that the long-term outlook of FHA and the MMIF are now much better than they were in 2009."

In 2009, the MMIF capital ratio was .53 percent, today it is negative 1.44 percent, and you are drawing over $1.5 billion from the taxpayers. So do you still stand by your statement that FHA's outlook is improving?

Ms. GALANTE. I do believe it is improving. Look at each book of business that we have done.

Mr. MCHENRY. Improving?

Ms. GALANTE. 2010, 2011, 2012.

Mr. MCHENRY. So you are saying you are in better shape now than you were in March of 2012?

Ms. GALANTE. I am not saying we are in better shape. I am saying we are rebuilding our trajectory. Again, I want to go back to, these are based on economic changes in the environment.

Mr. MCHENRY. So is the housing market worse today than it was in March of 2012?

Ms. GALANTE. No.

Mr. MCHENRY. No, it certainly is not. So let me go to another question here. In February of this year when you testified before this committee, you expected a capital reserve of $8 billion by the end of 2013. Do you still expect that?

Ms. GALANTE. Again, we will have a new actuarial coming out. It would have been mid-December—mid-November, but given the shutdown, it will be—

Mr. MCHENRY. Sure. We are sitting at the end of October.

Ms. GALANTE. Yes.

Mr. MCHENRY. And let me just take a gander, just take sort of a guess, if you will, or take a look over the horizon. Do you think you will be close to that $8 billion you projected in February?

Ms. GALANTE. I am not going to make an estimate, sir.

Mr. MCHENRY. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair will now recognize the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman, and thank you, Madam Chair, for being here. I'm sorry, I am feeling a little bit under the weather. I am a little cloudy, but haven't we done this hearing about 42 times this year? It seems like deja vu all over again. And I am just wondering—I know the numbers have changed a little bit because numbers change, but am I wrong to think, the last I heard you have about $48 billion in liquid assets at the FHA? Is that a right number or close to it?

Ms. GALANTE. That is correct.

Mr. CAPUANO. Is there anybody in their right mind who believes that absent unforeseen circumstances, but with the current market, you would utilize that entire $48 billion in the coming fiscal year?

Ms. GALANTE. Not that I know of.

Mr. CAPUANO. Not that I know of, either. So you have $48 billion sitting in the bank. And because of some stupid Federal law, you have been required to access taxpayer money. By the way, are you familiar with H.R. 1028, the End Unnecessary Borrowing Act of 2013?

Ms. GALANTE. I have seen it, yes, sir.

Mr. CAPUANO. Do you think that is a good idea? You don't have to say anything—

Ms. GALANTE. If you—

Mr. CAPUANO. —because I know you do. That Act would stop this stupid borrowing and get us off of this treadmill. If you were in trouble, I would be happy to jump on you, pound you pretty good. You have $48 billion in the bank and you don't think you are going to have to use it, and yet, we are having another hearing today.

Friends of mine just bought a $200,000 condo. They put $50,000 down. That is pretty good, right? They had to borrow $150,000. They have an auto loan, they have some credit cards. They owe about $175,000, and they have about $10,000 in the bank. Oh, my God, they are $165,000 of negative net worth. Call the police. Everybody I know has negative net worth, except a few people on the other side, apparently. But if they still get loans and things go on, there is no Federal law that I know of that would require my friends to make another borrowing simply to have money there in case—do you know of any Federal law that would require my condo owners to do that?

Ms. GALANTE. I do not.

Mr. CAPUANO. Yet we have one for you. Is there any other agency in the Federal Government or State government that you know of that has $48 billion sitting in the bank, that they probably won't use, but is required to access the Treasury?

Ms. GALANTE. I can't speak to other State agencies.

Mr. CAPUANO. I knew I was not feeling well when I got here. I am feeling worse now. I just wanted to—I am looking forward to the next seven hearings we have on this exact same issue, with the exact same answers, that we don't need to borrow this. Why don't we just pass H.R. 1028 to stop stupid requirements of stupid borrowing that no one needs? But we won't do that because it is too simple; it avoids us having these hearings to pretend to beat up on people who are doing their job exactly as required and that don't need to access Federal taxpayers.

For the first time in my life, I will actually give back the time that I have unused because I can't think of anything else that would add any light to this hearing that we haven't already said. With that, Mr. Chairman, I yield back the remainder of my time.

Chairman HENSARLING. The gentleman yields back. The Chair recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Over the opening remarks and some of the things that have been said recently with regards to bailouts, I really can't let slide the comments about this being simply an accounting entry. I just—this is not voodoo bookkeeping here. The comments have been made and the testimony has been given many times from Members on both sides of the aisle here that there is a $1.7 billion transfer of money. That is not an accounting entry. That is a transfer of taxpayer dollars to the tune of $1.7 billion. And to paraphrase here, if it looks like a bailout, by definition it is a bailout. Because what are we doing here? We are paying losses and recapitalizing the FHA.

What did we do in 2008 with all of the banks and the financial institutions, and what have you? We paid losses and recapitalized their accounts, their institutions. So for us to sit here and argue semantics over whether it is a bailout or an accounting entry I think is a red herring and really denigrates our discussion today.

Let me move on. I am kind of curious. You made a comment a while ago—and the discussion was had—that you make your decisions within FHA based on the economic conditions of how you adjust your criteria on whether you make loans, on who you make them to, and that sort of stuff. Over the last couple of weeks here, we have had some discouraging news with regards to the number of home housing starts, unemployment stabilized at where we are at, but the number of new jobs being created actually is probably a little bit less than what it takes to maintain our folks with where they are.

At the beginning of the year, we are going to have a QM rule coming out, a QRM rule that is going to be, I believe, devastating to the home lending market because of the requirements that are in it. And as a result, I am kind of curious, what is FHA doing to prepare itself for these things that are coming here? If we have a little downturn in the economy, are you ready? Do you have any ideas, some plans that you are going to put in place to protect taxpayers dollars so we don't go back and have to have another $1.7 billion next year? And what are your concerns about the QM, QRM rule coming here at the beginning of the year with regards to mortgage lending?

Ms. GALANTE. Let me make a couple of comments. First of all, we are not trying to deal with semantics on this accounting transfer.

Mr. LUETKEMEYER. I realize you are not, but there are a lot of folks who were.

Ms. GALANTE. What I want to make clear here is the difference between what FHA is doing, and what happened to private financial institutions who were making private gains and then the government had to come in to "bail them out." That is very different than the fact that FHA, every piece of revenue, every dollar that we earn, goes back into the Federal Treasury.

Mr. LUETKEMEYER. Ma'am, where do you think the money from the private sector goes? By definition, when you paid losses and recapitalize a business or an institution, that is exactly what we are doing right here.

Ms. GALANTE. Again, we are transferring dollars—

Mr. LUETKEMEYER. You are arguing over semantics as well.

Ms. GALANTE. —so that we have in reserves enough to pay our costs. All of our money goes back to the Treasury. I get paid the same amount of money, which isn't much, regardless of how much money we generate for the Federal Government, and to the CBO chart if you add in 2013—

Mr. LUETKEMEYER. Okay, I am running out of time. Please answer my other questions if you would, because we are arguing semantics here. Can you answer my other questions? Are you being prepared, are you looking at a possible downturn and what are you doing to prevent that? And what are your thoughts on QM?

Ms. GALANTE. Again, I don't control what happens in the economy. I really hope we don't have another downturn, but we are—

Mr. LUETKEMEYER. Ma'am, you just testified that you look at, from the economic projections and make changes and adjustments to your program. I am asking, what are you doing?

Ms. GALANTE. Let me clarify. The economic projections are used to value the existing portfolio. What we look at in terms of our underwriting criteria is, what do we need to do pricing-wise, credit-wise to ensure that we are pricing our risk appropriately and taking the right risks? And we have done—I have listed those out, we have done a number of measures over these past 5 years to protect ourselves going forward, and it shows in our new books of business. Our current books of business are extremely profitable, and very safe.

Mr. LUETKEMEYER. Okay, what are your opinions on QM after the first year? How is this going to affect the mortgage market and affect you?

Ms. GALANTE. FHA has its own QM rule that is out for public comment. In fact, public comments are due on the 30th, I believe.

Mr. LUETKEMEYER. I see my time has expired. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Mr. Chairman, with all due respect to you, this isn't a hearing. This is a sham, and not only is it a sham, it is a shameful sham of deceit. First of all, trying to use the word "bailout," and ladies and gentlemen, Mr. and Mrs. America who are watching this, just coming from this other side, my friends on the Republican side just 2 weeks ago shut down the Federal Government, shut down the Veterans' Memorial, and they were high-fiving, congratulating one another, and then going out the next morning right down to that same Veterans' Memorial and blaming the poor park rangers for shutting it down.

These are the people who are bringing this shame, and this sham, who furloughed 800,000 jobs, shutting down the Federal Government when they take, just like we do, that solemn oath to uphold the Federal Government, to defend the Federal Government, to protect the Federal Government of the United States of America, and every act up here in this committee, no matter what it is, their sole purpose is to try to destroy this Federal Government, and no greater example than right here.

Because, Ms. Galante, you and the FHA have done a remarkable job and under great difficulty. We went through the worst recession, coming up almost to the Depression of the 1930s, but yet, and still, the amount of stability that you gave to the housing market, particularly for the lower income and middle income and sustainability deserves four stars, or five stars, not this. But it is very important that we understand where this fiasco of criticism is coming from. There is no credibility on that side of the aisle when it comes to the financial stability of this country, when it was they who took this country to the brink of bringing the entire world economy down because they wouldn't allow us to raise the debt ceiling to pay the debts that we have.

Now, Ms. Galante, is it not true that we have an act that was passed in 1990, the Federal Credit Reform Act, that you are obeying, that you are required to have sufficient funds available to meet your obligations, much like the United States has. In order to remain strong, it requires you to have this over a 30-year period. Is that not true?

Ms. GALANTE. That is correct, over the life of the loans.

Mr. SCOTT. Over the life of the loans, so that if you were to close your door today and be out of business, the law would require you to have this mandatory appropriation, to be able to carry your duties out for 30 years. And the hurtful feeling to me is to see my friends on the other side use the American people with this fake language of bailout when we have crossed that bridge, when we have written it into statute that no taxpayer's money will ever again be used to bail out anything. This is required of you by law.

Now, let me ask you this: Isn't it true that because of the interest rates that have risen, because of the mortgage insurance premiums that have been increased, that it has reduced the FHA's loan volume, and thus revenue that is used to offset future losses, and is not that why it is written into the law that this $1.7 billion is there to bring you in compliance with the law?

Ms. GALANTE. That is correct. We have shrunk in volume significantly, particularly at the end of this quarter.

Mr. SCOTT. Thank you. And let me just say to my Republican friends on the other side, let's cut this out and let's move this country forward.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Amen, hallelujah. Amen, hallelujah. Except we are just sitting here and I have just been told that I am trying to destroy the Federal Government, when in fact, I am trying to fix it, hold it accountable, and make it more efficient. I have just been labeled someone who is taking part in a sham because I am asking hard questions. Now, what I am curious to know is why this Administration is insistent on flim-flam and snake-oil sales? Because that is exactly what we are hearing about. But we are going to get righteous indignation from the other side who was here. I wasn't here. I am in my second term, just starting my second term. I wasn't here when a lot of this was all created, but you are seeing from the people who wrote the bill, not on a bipartisan fashion, with one party who wrote the bill who no longer wants to adhere to the language of that bill that they wrote, and who are now trying to blame me for coming in and trying to fix it.

That gets a little frustrating. It gets a little frustrating. I think the American people who are watching this hopefully should be frustrated, too. My background is in real estate and development. And as I am looking at your chart on page 2, as you have noted a couple of times, my real estate career starts right at about the beginning of your chart, in fact a little bit before. And it just strikes me, as I am noticing a little bit of blue, a little bit of red, a little bit of blue in there. For those of who you don't have the pleasure of seeing this on TV, it is positive and negative.

It is also about market share. It is not about how much or how little. Then it starts blowing up in 2000 and you start seeing a massive downward slide, and let's explore what happened. What happened is, FHA started to expand its footprint pretty dramatically, and especially starting in 2003, through on to where we currently are. I am a student of history and I am kind of reminded of Europe during World War II. We had the Allies versus the Axis. Okay, that was a righteous fight. But what happened? After the fighting, we had East versus West. And at one point the West said, you know what, we liberated Holland, we liberated Belgium, we liberated France, we liberated Germany, and the Soviets also did that. But guess what? We left and they stayed. All right.

And what I want to know is when are the Soviet troops going to withdraw from the territory that you have conquered? The massive amount of involvement that the FHA, which is intended for low- and moderate-income homeowners buying a home for the first time, when you are going to actually let that happen, because the massive expansion of the footprint of FHA concerns me. Because you are now strangling what the private sector should be doing, and we are having the Federal Government come in, label more requirements, have just additional requirements that they are putting in place, and frankly, putting the Federal taxpayer on the hook. I want to fix it. I want to fix this, and I want to make sure that we are serving those low-income, first-time home buyers. And by the way, it is not about race. It is not about geography, and I have heard that brought up by a couple of my colleagues on the other side.

When I got my REALTORS® license, they taught me that people aren't black, white, yellow, or red. They taught me that they are green. And what I mean by that is, they can either afford it, or they can't afford it. They are not black. They are not white. They are not yellow. They are not red. They are green. Can you afford it or not afford it? And unfortunately, my friends on the other side seem to blur that a whole lot and I want to fix this.

It seems to me that the work that this committee has done on the PATH Act is one of those things. I would like you to comment if you would, please, on that, and whether you believe that you are actually serving the low-income, first-time home buyer, which is the original intent of this program.

Ms. GALANTE. A couple of things, Congressman. First, I think that you are conflating the chart which looks at the economic value of these books of business, which includes—part of the reason the blue charts in the late years are as high as they are is because we have increased premiums. So, we are bringing in a lot more. They are worth more because we are bringing a lot more.

Mr. HUIZENGA. And what was your—what has been your footprint, though? In 1992—

Ms. GALANTE. Let's talk about, I have back to 1999.

Mr. HUIZENGA. Great.

Ms. GALANTE. And I just want to say, FHA insured 1.23 million loans in 1999. How many did we insure in 2013? 1.29.

Mr. HUIZENGA. And how was—no, no, time out, time out. You cannot get away with this, because you have to look at the overall market and market share and percentage.

Ms. GALANTE. Yes.

Mr. HUIZENGA. Market share and percentage. That was back in the day, getting an FHA loan was difficult, and frankly, it was tough to work with; not so much anymore. That is what we have to reverse. That is what we have to go back and we need to put FHA back into the box that it was intended for, not to have it expanded. My time has expired. I'm sorry.

Ms. GALANTE. To be clear, our market share has dropped from its peak at 27 percent and it is continuing to drop.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witness for testifying. And since the indication is that we are talking about people who are not red, black, or white, but they are green, I assume we are talking about me, I happen to be green, Al Green.

Mr. HUIZENGA. If the gentleman will yield?

Mr. GREEN. Of course, I will. I yield to my—

Mr. HUIZENGA. I wish there were more people like you who were green, not just in name, but who could afford all of this.

Mr. GREEN. Thank you very much, and I have been blessed. I tell people all the time that I am better than I deserve to be. But let's talk about reality for just a moment. And I would like to have you give some testimony today, since you are clear, so let's talk about why FHA finds itself in the position that it is in. FHA is not a for-profit business. Is this a fair statement?

Ms. GALANTE. That is correct.

Mr. GREEN. And FHA was established more than 80 years ago. Would you state what the purpose of FHA was 80 years ago, and what it is currently, please? And if those two are the same, please make note of it.

Ms. GALANTE. As you may know, FHA was established immediately after the Great Depression partly to get the economy back on its feet again, to get people working again, to get homes built, and to get people being able to live in those homes at reasonably affordable prices. And it was not just for one classification of borrower. There is nothing about it that was only for low income, for example.

Mr. GREEN. As a matter of fact, when it was established, there was no contemplation that it would help any specific class, but probably when it was initially established, the beneficiaries were rarely—not to a great extent, African-Americans or Latinos. Is that a fair statement in the infancy of FHA?

Ms. GALANTE. Not having statistics, I would say that is probably a fair statement.

Mr. GREEN. So FHA was not established to help African Americans or Latinos, but as time has evolved, FHA has been of benefit, and it did, after the Great Depression, a good thing. Was it of benefit to this country to have FHA after the Great Recession?

Ms. GALANTE. Yes, absolutely. As you have heard quoted before, economist Mark Zandi has said that if the FHA had not been in the market during that worst recession, we would have had a worse economic crisis by property values dropping 25 percent more than they did, therefore making the economic recession even worse.

Mr. GREEN. I, like my colleagues, am of the opinion that FHA has served a meaningful purpose. It has done what it was designed to do. And I think that we need to continue this effort with FHA, so I would like to ask you a question now about in-person servicing. FHA seeks to help persons who are having some difficulty with their mortgages. In-person servicing is an option, and the information that I read on this, the intelligence seems to indicate, to connote that you get greater results if you can perfect in-person servicing as opposed to doing it by way of email or some other form of servicing.

We have a piece of legislation that would allow firms, businesses, to work with FHA to perform in-person servicing to modify loans, to get engaged in short sales, to refinance, and my question to you is, is that something that we can talk to you about, this in-person servicing, so that maybe we can save even greater numbers of persons from having to go into foreclosure?

Ms. GALANTE. I would be happy to have more conversation with you about that. I do believe that high touch, so to speak, helping existing homeowners in any way that we can, if we can get them to re-perform, if we can get them to stay in their home, that ultimately is going to help the fund as well as the homeowner.

Mr. GREEN. Thank you. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. Thank you very much, Mr. Chairman. Ms. Galante, I can assure you, this is not where I was going to take my original line of questioning.

I was actually going to ask you about something other than the bailout here today. But then you said something that struck me, and I have to come back and talk to you about it. You were talking about how you get paid the same amount whether or not you do a good job or do a bad job, and that you don't make that much. How much do you make?

Ms. GALANTE. $150,000.

Mr. MULVANEY. Is that really not that much, Madam? We are sitting here talking about a national debt of $17 trillion, and the impact on an ordinary family. Is that really how you feel about this job?

Ms. GALANTE. Let me be clear. I was using that in the context of private sector companies with private profits, and private compensation plans, that then came to the Federal Government, so as a relative—

Mr. MULVANEY. No, I am less worried about the amount of money, Ms. Galante, as I am about the attitude—

Ms. GALANTE. Just to clarify—

Mr. MULVANEY. Excuse me. I am worried less about the amount of money, because that is really none of my business. It is because it is public, but about the attitude that you get paid the same whether you do a good job or a lousy job. What kind of job security do you have?

Ms. GALANTE. That was not—

Mr. MULVANEY. What does it take to get you fired?

Ms. GALANTE. I serve at the pleasure of the President.

Mr. MULVANEY. I am sitting here and again, this is not where I was going. But I am sitting here, I have been here like Mr. Huizenga, my colleague. I have been here for 3 years. In the last year, I have seen four people get killed in an embassy in Libya and nobody got fired. I have seen an IRS turn on its own people and target people based upon their political beliefs and nobody has been fired. I have seen us spend half a billion dollars on a computer program that doesn't work, and nobody has been fired. And then I see stories about somebody who is a phone operator making $26,000 a year, who says one wrong thing on the radio, and immediately gets fired.

I have a tweeter—somebody tweeting inside one of the agencies who immediately gets fired. And I just want to know where the outrage is. I want to know where the even treatment is. I want to know why somebody can come into this meeting and say, I make the same if I do a good job or a lousy job. But I don't make that much. It is only $150,000 a year. But we sit here and we have no outrage when ordinary Americans get treated poorly by their own government, whether or not they are being mistreated by the agency or whether or not they get fired—$26,000 a year and you get fired for saying the wrong thing on the radio.

Is there no outrage for that type of reaction? People are afraid of their government. They are afraid of exactly what Ms. Galante has said today, which is we have a faceless bureaucrat who doesn't really care if she does a good job or a bad job. She is just here to pick up the check. I want to know where the outrage is. With that, I will go back and ask my original questions.

There has been a lot of talk in the industry about using eminent domain to try and solve the mortgage crisis. Several agencies, most recently the FHFA, have taken a very aggressive position on this position. They have said: "On balance, after conducting a review of law and markets and considering public input, there is a rational basis to conclude that the use of eminent domain by localities to restructure loans for borrowers who are underwater on their mortgages presents a clear threat to the safe and sound operations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks as provided in the Federal law, would run contrary to the goals set forth by Congress for the operation of conservatorships by FHFA and present a direct relationship to their responsibility for overseeing entities."

Why haven't HUD and FHA taken a similar position? You were asked in June by the Senate if you supported, or what your thoughts were on these type of eminent domain proceedings, and you said that it was too early to know. To me, that is like waiting until somebody gets killed to find out if murder is wrong or not. Why aren't you doing the same thing that the FHFA is doing and taking a definitive position on this stunning development on the West Coast about using eminent domain in order to take people's houses?

Ms. GALANTE. First of all, Congressman, I want to start by saying I am very proud of my Federal service, and I left my entire life across the country in California to come here and serve this Government and this Administration. And you have taken my comments entirely out of context. I was—

Mr. MULVANEY. Fair enough. It happens to me all the time, so I appreciate your concern. Do you want to answer the question about eminent domain or not?

Ms. GALANTE. Yes. In response to your question, FHA continues to monitor the situation.

Mr. MULVANEY. Monitor the situation. They are already doing it. Why does the FHFA not have to monitor the situation and you do?

Ms. GALANTE. I want to make two points on this. The first is that eminent domain is a local and State obligation or authority, and—

Mr. MULVANEY. You will be asked to guarantee and insure these loans. What is your position on that?

Ms. GALANTE. We don't know that is the case, number one. Number two, this was the second point I was going to make. I just want to be clear. The FHFA and Fannie and Freddie are in an entirely different position than the FHA, because they own some of these private label type securities. FHA only insures for its own book of business. We didn't buy—

Mr. MULVANEY. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. I can't recall the day, but like many of you, we all probably studied or became familiar with this dawn-to-dusk discussion and debate at the beginning of the 19th Century between Albert Einstein and David Hilbert. And maybe I am the only person who remembers this kind of stuff, but they had a dawn-to-dusk debate on physics, and one of the reporters who covered this discussion wrote that they were talking past each other, which is kind of the—either the beginning of that phrase, although I think it goes back to some kind of English theater, talking past each other, and that is what is happening here.

I was speaking to a group of people at the Savoy Club in Kansas City, and as we were—during the question-and-answer period, they said that they didn't watch C-SPAN, the hearings, because they couldn't get anything out of it because the Members talked past each other, and that it was so confusing that they had made a decision to just not watch.

And I don't blame them. If they are watching this, I want to apologize—where is the camera—for you having to go through this. I hate to see it. Alphonso Jackson was Secretary of HUD. I met him back when he—I preached, many times, at the St. Luke Community United Methodist Church in Dallas which he attended. And I didn't agree with him. I would never, ever, ever in this committee or anywhere else, accuse him of coming to take his check and not caring about his job.

And I'm sorry that has been said. I apologize. I made all of these notes to ask what I thought were reasonably intelligent questions concerning HUD. I want to do it. I am kind of hurt over the way we have come to treat people here in this Congress. So I apologize, and I don't want to participate. I yield back.

Chairman HENSARLING. The gentleman is yielding back. The Chair now recognizes the gentleman from Florida, Mr. Ross, for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman. Ms. Galante, the intent of the FHA, of course, is to help those—I apologize, I can see l you better this way. The intent, of course, was to make sure that we had affordable housing, that low- to moderate-income people could have access to the American dream of homeownership. To that extent, at the height, I guess, of the boom, the market share that FHA had was about 2 percent. Today, it is about 56-some percent, which leads one to question a lot of things, especially not only how and why it happened which we will have that debate for quite some time, but specifically, with regard to the future, do you have an opinion as to whether there is sufficient private capital, capacity of private capital in the market to return to the days where the FHA only had 2 percent of the market in mortgage insurance?

Ms. GALANTE. Let me just say that FHA had 2 or 3 percent of the market, as you said during the ramp up to the bubble. Our normal market share ranged over time from 10 to 15 percent; that would be kind of the normal market share. We are actually at I think 12, 13 percent today. The challenge to the private capital that you speak of is that the entire market has shrunk, and that private—

Mr. ROSS. But why has the market shrunk? It is not because there isn't sufficient capital. Is it because of the rates? Is it because they are trying to compete against a monopoly called the FHA?

Ms. GALANTE. No, I think, sir, this is really important. The FHA is not competing with the entire broad market. We—the MI companies, for example, I would say their market share over the past couple of years has been coming back steadily, and their pricing is now—

Mr. ROSS. Is it competitive?

Ms. GALANTE. —is better, is competitive for basically anybody over a—FICO score today, yes.

Mr. ROSS. Approximately 25 percent of the endorsements that FHA has are made up of loans that are considered high to be to high-income borrowers, and that shouldn't be the function of the FHA, should it? This should be ceded to the market, shouldn't it? At one point, it was 16 percent. Now, you are up to 25 percent of the high-income borrowers. So that is in an area that we should address, shouldn't it?

Ms. GALANTE. There are two areas we should address. One is the global market, and that is going to take—and I appreciate the efforts on the PATH Act—resetting the entire housing finance system well beyond FHA so that private capital understands how to play and has the right—

Mr. ROSS. If they are given the opportunity to play.

Ms. GALANTE. —framework to do that. But FHA, in terms of its market share, we ramped up. In 2009, we dropped way back down, and—

Mr. ROSS. The maximum mortgage loan value of $729,000, that is usually considered for a high-income borrower, wouldn't it be?

Ms. GALANTE. So again—

Mr. ROSS. In my neighborhood in central Florida, it seems like it would be.

Ms. GALANTE. That is only for high-cost areas, and to be clear, that expires in January of 2014.

Mr. ROSS. It goes down to what?

Ms. GALANTE. These were congressional limits that were put in place, and FHA has operated within those. They expire in January.

Mr. ROSS. Of course, my friends on the other side say this is not a bailout. It is just policy and it is an accounting function. Regardless of what it is, just because it is policy doesn't mean it is good. And I think it is a bad policy that we now have to have the Treasury issue a check for $1.7 billion to make up for a shortfall.

Do you think it would be in the best interest of not only the FHA, but quite frankly the Treasury as well to have it repaid?

Ms. GALANTE. Again, over time, everything that FHA earns goes back to the Federal Government.

Mr. ROSS. And with regard to your capital standards—let's face it, FHA has the best capital standards if they even exist. Why wouldn't the private mortgage insurance companies be allowed to subject themselves to the same capital standards that the FHA has? Would that not, in and of itself, create a more viable market of private capital?

Ms. GALANTE. FHA exists as a government entity. It is very different than a private mortgage insurer.

Mr. ROSS. But it competes against the private mortgage insurer, and that is my issue here.

Ms. GALANTE. They play different roles. Private mortgage insurers are normally guaranteeing a top amount of mortgage insurance with—

Mr. ROSS. So you don't think they should have the same capital standards?

Ms. GALANTE. They are regulated by State agencies, State governments.

Mr. ROSS. It is okay to say no. That is okay.

Ms. GALANTE. I am just saying, it is a different business and it is regulated differently. It is entirely different.

Mr. ROSS. My time has expired.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman. Ms. Galante, this term "bailout" has been thrown around a lot, and I don't want to belabor it, but when I think of bailout, I am thinking about AIG, I am thinking about Citi, I am thinking about General Motors. These were all privately-owned companies that but for our government assistance, would maybe not exist, and probably in their collapse would have caused a lot of damage to the economy. I guess my question is this: Is FHA in danger of imminent collapse?

Ms. GALANTE. No, sir. Again, FHA is part of the Federal Government.

Mr. ELLISON. So I heard the term thrown around in terms of how much liquid cash assets you have and the number I heard was $48 billion?

Ms. GALANTE. That is correct.

Mr. ELLISON. So to sort of talk about FHA being in a bailout situation, when the historic precedent for it is Citi, General Motors, AIG, is really misleading. Would you agree with that?

Ms. GALANTE. I agree with that.

Mr. ELLISON. Thank you. Now, another thing that happened that I just would like to shed some light on, you were asked about FICO scores, and whether or not a person would be eligible for the services of FHA if they had a 550 FICO score.

I don't believe you were allowed to answer the question fully, or fairly. Can you explain the total scorecard and manual underwriting process just so people watching this can have an accurate idea of exactly how you make decisions.

Ms. GALANTE. Yes, thank you. So we have a system where we—our lenders can look at, underwrite a borrower based on their FICO score, based on their income, their projected income over time, based on their ability to make the downpayment. All of that goes into an automated underwriting system. We also, if they don't make it through that underwriting system, the lender can look at compensating factors and determine a holistic nature of that borrower, and whether they have the ability to adequately repay the loan.

And this is fully documented, unlike the question where we were talking about "subprime," where those were in the crisis, no documentation, all of that. That is not what FHA is about. We ensure that our lenders are fully underwriting these borrowers.

Mr. ELLISON. Thanks for that elaboration. And I would also just like to say that I think you are a dedicated public servant. I know that based on your expertise, you probably could be receiving way more money than you are now, but what you are doing is a public service, and what you are doing springs from your patriotism, your commitment to our country.

So I want to say thank you for that. And I want to let you know that there are literally thousands and thousands of people who work for the Federal Government who do it out of love, commitment, and passion for our great Nation. So with that, I yield back. Thank you.

Mr. HUIZENGA [presiding]. The gentleman yields back.

With that, I am checking just to make sure, my colleagues, it is going to be the gentleman from Georgia, Mr. Westmoreland, for 5 minutes.

Mr. WESTMORELAND. Thank you, Mr. Chairman, and thank you ma'am, for coming today. And the first question I want to ask is just for informational purposes, and is not related to FHA, but you are a Presidential appointee, is that correct?

Ms. GALANTE. That is correct.

Mr. WESTMORELAND. Are you under the Affordable Care Act? Just as—that is—

Ms. GALANTE. I don't think so. I have no idea, to tell you the truth.

Mr. WESTMORELAND. Okay, so you don't know if you would be covered under the Affordable Care Act or not?

Mr. GALANTE. I am covered as a Federal employee. I get my benefits through the regular Federal program.

Mr. WESTMORELAND. Okay. So you will remain with the insurance that you had compared to the Members of Congress, and staff, and stuff?

Ms. GALANTE. Correct.

Mr. WESTMORELAND. Okay, thank you. I know that Mr. Himes has stated that the $1.7 billion was a part of money that you had to have. It was a mandatory appropriation to get the level up to where you should be in case of another collapse or failure. Why don't you have that money, when there has been a requirement of a 2 percent fund, and FHA has failed to be able to get that reserve even though that you have had permission through legislation to increase fees and other things to get to that 2 percent level? Is it not true that the reason that you are having to get the $1.7 billion is because FHA has refused to raise their fees to really comply with the law?

Ms. GALANTE. Congressman, we have raised fees. We have raised fees 5 times. We have changed our policy to, we have reversed canceling mortgage insurance premiums after a certain period of time. We have made a number of changes, including premium increases, that directly increase our revenue to FHA.

The challenge is, those are on new loans moving forward, and if you put the increase in fees too high on the new loans, those will be profitable. As you can see in that chart on page 2, they are extremely profitable. They can't go back and make up for the challenge of the loans that were done well before we got here in the midst of the recession, and so the economic value of those books of business has continued to be a drag on the FHA.

Mr. WESTMORELAND. Do you think it is a problem that FHA does the insurance on homes up to $729,000, or whatever that amount is? Do you think that is a problem rather than—I don't know many first-time home buyers who go into that kind of house. So do you think that FHA has gotten a little bit out of where the original intent of FHA was at when it was started?

Ms. GALANTE. We have stated publicly many times that we think the loan limits ought to come down. These were, as part of the countercyclical role, Congress gave Fannie, Freddie, and the FHA the ability to make higher loans during the height of the crisis. That higher loan limit expires on January 1st of 2014, and FHA will go back to the limits that were put in the HERA legislation.

Mr. WESTMORELAND. What would that limit be?

Ms. GALANTE. It will be for high-cost areas, I think it is $625,000. But again, FHA loan limits will be a percentage—

Mr. WESTMORELAND. Right.

Ms. GALANTE. —in most of the country.

Mr. WESTMORELAND. I am running out of time, so let me just ask one further question. I know that you were talking about, do you think that in order for FHA to comply with the law, you need to have a reserve fund of 2 percent?

Ms. GALANTE. Over time, I absolutely believe we need to get it.

Mr. WESTMORELAND. If so, how long do you think it will take to get to that point?

Ms. GALANTE. Again, we have an independent actuary look at that each year. I think last year, which is the most recent available, it was 2017.

Mr. WESTMORELAND. When? 2017.

Ms. GALANTE. 2017.

Mr. WESTMORELAND. 2017, so that is about 3 years from now, to where you can get up to where you are just in compliance with the law.

Unfortunately, most people who aren't in compliance with the law have some type of penalty, but it seems like if a government agency doesn't comply with the law, there is no penalty. So with that, I will yield back.

Mr. HUIZENGA. The gentleman's time has expired. With that, we will recognize the gentleman from California, Mr. Sherman for 5 minutes.

Mr. SHERMAN. Thank you. First, in response to the gentleman from South Carolina, you are getting paid $20,000 less than we are. He is outraged that those in the Administration aren't fired often enough for his beliefs, but I would say you are doing a good job under trying circumstances. And as to those getting fired, I point out that we in Congress shut down the U.S. Government. None of us have been fired yet. And if we are going to have a list of ways in which Washington has failed the American people, I don't think the FHA is on that list, but I know Congress is.

I want to pick up on Ms. Maloney's questions about high-cost areas as you point out. If we don't act, we are going to see a drop. This is a great country, and things vary from one area to the other. There are a lot of Members here from places where for $729,000, you buy the biggest home in town. I represent an area where there that is a middle-class family. And I would like you for the record, these loans between $625,000, and $729,000, as I understand it, they performed well. They have low rates of default, and they are not considered to be a weak part of your book of business, is that correct?

Ms. GALANTE. That is correct. I would also add it is not a very—it is like 2 percent of our entire portfolio. It is a very small amount that are up at the higher loan limits.

Mr. SHERMAN. So it is 2 percent of your business. It is absolutely critical to my district and Carolyn Maloney's districts, and while it is hard to calculate, you are not losing money on this. In fact, you are making money on this 2 percent, as I understand it, is that correct?

Ms. GALANTE. As far as I know, today, yes.

Mr. SHERMAN. Okay, so we can increase government costs, and cause a spectacular decline in home values in high-cost areas by allowing the current limit to expire. I would hope that if Congress wants to bring its approval rate above its current levels that we would instead authorize you to continue your program for high-cost areas.

As to reverse mortgages, you have indicated that it is not a significant strain on the FHA, more specifically, the Mutual Mortgage Insurance Fund. If the HECM program, which is basically reverse mortgages, was not part of that program—the MMIF fund, would you still need the infusion of cash that you need?

Ms. GALANTE. No, the reverse mortgage program, as you can see on the chart on page 8 in my written testimony, clearly demonstrates that but for that program, we would have a positive capital.

Mr. SHERMAN. So you are saying that has been a problem for—

Ms. GALANTE. The—again, legacy mortgages for the reverse mortgage program, we have made changes with the help of Congress, but the legacy mortgages—again, they got hit hard by the recession as well, have been problematic.

Mr. SHERMAN. Have you made changes so that you expect to lose money on those programs in the future or not? The reverse mortgages?

Ms. GALANTE. No, we have made changes so that we will not lose money on those in the future.

Mr. SHERMAN. Finally, I have one element of agreement with the gentleman from South Carolina, as strange as that may seem, and that is the eminent domain issue. We now have, unlike most countries in the world, non-recourse mortgages, you buy a home, and if you want, you can walk away from it. In Europe, you still owe the money on the mortgage. And now, there are those who say we want to go even further than that and say if you buy a home and the price goes up in value, you keep all the profit of, course. And if it goes down in value, you keep the home and you just tell the lender to write down the mortgage through a process called eminent domain.

If that becomes the norm, what does that do to Fannie, Freddie, and FHA solvency if we create a system in which most towns in America, if you don't like your mortgage principal amount, you just go through a process and it is written down.

Ms. GALANTE. Let me be clear, my view is that eminent domain is a local tool that can be used by localities. We are happy to issue informational guidance if it becomes necessary around eminent domain.

Mr. SHERMAN. You need to stay out of that.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman. And thank you, Ms. Galante, for being here with us today, and thank you for coming from California and for your sincere efforts.

Ms. Galante, as I have been a new Member of the Congress on this wonderful committee, I have learned a great deal about the impact of the Dodd-Frank Act, the role of the Consumer Financial Protection Bureau (CFPB) and its oversight over financial institutions, and the fact that if they don't reach certain standards, the CFPB can put them out of business and penalize them or whatever.

Given the same sense of accountability, do you feel that accountability in your role? Obviously, the capital standards haven't been met, but you are able to function, and nobody's going to put you out of business. As you said several times, you work for the Federal Government and so the taxpayers are here. You stated this last month that needed \$1.68 billion. We heard in 2009 that HUD said FHA was stable and sound and secure for the future.

So this creates a lot of concern with the American people. I think they certainly felt the gravity of \$17 trillion debt and it keeps mounting. You are part of a government that has accrued an enormous amount of debt. Peter Orszag, a former budget writer, Erskine Bowles, Paul Ryan, they are all saying the same thing—that our spending is out of control and unsustainable and will collapse like Greece. They have all said it in many ways. So I would hope that you would share that concern and accountability back to the American people.

I think as you spoke to us, as you spoke and you appeared before the committee in February, you said then that you tested the financial health of the FHA, and yet right after that, the next day, the Government Accountability Office added your agency to the list of government programs that are identified as, "High risk due to their greater vulnerability to fraud, waste, abuse, and mismanagement or the need for transformation." How do you respond to that? What is your—do you feel, do you understand the impact of the role that you are having and that you would be considered a high-risk agency to the taxpayer?

Ms. GALANTE. Let me be clear, I take my responsibility extremely seriously in terms of running the FHA, and we have worked incredibly hard to keep the market going, to keep access to credit and rebuild the reserves of the fund. And, we have listed out those actions and we continue to work hard every single day to make this as strong a fund as possible, and as strong an agency as possible. I have read the GAO high-risk report, we have regular conversations with the GAO. We are working on all the recommendations—

Mr. PITTENGER. Would you admit that these are very strong words, "vulnerability due to fraud, waste, abuse, and mismanagement or the need for transformation," that is about as strong as you can get.

Ms. GALANTE. The GAO does recognize there is need for transformation, business transformation activities, IT transformation activities, I believe is what the quote is related to. The quote in the high-risk report I would say, GAO acknowledges that we are improving our condition by increasing fees and underwriting changes. So part of the reason FHA was put on the high-risk list is that the housing finance system, without further reform of the entire system, puts all of us at risk.

Mr. PITTENGER. Let me ask you, it is imperative that the agency use every tool at its disposal to address the budget shortfall and protect the taxpayer. Do you believe that the agency has used every tool at its disposal to address the budget shortfall? If not, I guess I would have to raise the question of whether FHA is failing to properly manage its portfolio, which places the taxpayer at greater expense.

Ms. GALANTE. I believe we have used every tool at our disposal and we have made prudent and appropriate policy changes, whether that's increasing premiums or the many other changes that I have talked about here today. We also have to do that in a way that does not do further damage to the economy.

Mr. PITTENGER. Thank you. You do agree that if you were in a business, the CFPB would put you out of business?

Ms. GALANTE. No, I do not.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. And Ms. Galante, thank you for being with us today. I have been doing this for about 5 years, sitting in on this committee, and I don't think I have ever been quite as embarrassed as I am today by the tone and the substance of this hearing or by the way that you have been personally treated. You have been subjected to the entire repertoire, from Benghazi to personal queries about your health insurance. I think I heard you called a faceless bureaucrat. That kind of language and that kind of tone is beneath the dignity of this institution and earns us our single digit approval ratings, and it is violative of any standard of gentlemanliness that anybody sitting back here should presume to aspire to.

I used to work in affordable housing, and I am familiar with your work prior to taking this job. You took this job in December of 2012 at the request of the President of the United States, did you not?

Ms. GALANTE. Yes.

Mr. HIMES. So in 2012, 4 years after the meltdown, you came in—you might say that you came in really at one of the most difficult times in this Nation's housing and economic history because the President of the United States asked to you leave the good work you were doing in California with BRIDGE and you chose to do this.

Ms. GALANTE. Yes, I do want to, just for the record, be clear. I started in multifamily in 2009, and I became acting in mid-2011 in this position and confirmed in 2012.

Mr. HIMES. Thank you. In the past, you have advised the Cities of Richmond, Philadelphia, and Santa Barbara I think, and you are also a real estate broker. So is it fair to say you could be doing plenty of things other than what you are doing here now?

Ms. GALANTE. Yes.

Mr. HIMES. Let's talk a little about the people of FHA, because I want to transition now to this question of accountability which so fascinates the other side. Without in any way minimizing the reform that we might ask FHA to undertake, I do want to pull on this thread of accountability. I don't know the people of FHA the way you do, but I heard the chairman and others really demand personal accountability, and asked again and again, has anybody been fired, should somebody have been fired, why has nobody been demoted? Ms. Galante, have the troubles of FHA, in your opinion—is it in any way related to individual malfeasance due to witting or unwitting performance on the part of the any of the people who work at FHA?

Ms. GALANTE. Absolutely not.

Mr. HIMES. Do you think anybody at FHA could have done anything differently, could have worked harder or have been more prudent or been more thoughtful in a way that would have prevented you sitting here today with us talking about this $1.7 billion capital injection?

Ms. GALANTE. No, I do not. I believe we have done everything asked of us.

Mr. HIMES. In your agency, you are closely constrained by law and regulation that Congress has imposed. We were recently treated with the debt ceiling to an example of that where the Congress was going demand that the President of the United States violate some law. We say tax this, spend this, math—then requires a certain amount of borrowing, but by the way, you may not be able to borrow. So Congress was going to tell the President of the United States to violate some law.

Is it fair to say that under the strictures, the congressionally-imposed strictures and regulations of FHA, that FHA itself has performed as well as it could have under the circumstances?

Ms. GALANTE. I believe we have done everything to perform as well as we can.

Mr. HIMES. So that leaves the question of why are you here asking for a 1.7 billion, as the other side puts it, bailout?

Let me read you the last line the Majority staff's memo on this hearing. The last line, and just to be clear, this bailout as it is called is required because the MMIF is at 16.3—negative $16.3 billion in value, right?

Ms. GALANTE. Yes.

Mr. HIMES. Right. The last line of the Majority staff's memo reads, "The MMIF's negative 16.3 billion economic value represents a decrease of 17.49 billion from its 1.19 billion economic value at the end of fiscal year 2011," and here is the part I want to emphasize, "which resulted from further declines in national home prices, more loans having elevated default potential and uncertain economic conditions." This is the Republican memo saying that you are sitting here today because of the decline in national home prices and uncertain economic conditions. Is it fair what the Republicans are saying in their own memo? Do you agree with that?

Ms. GALANTE. Yes, as I have been saying, the value of the fund is greatly affected by economic conditions.

Mr. HIMES. Great. Do you think Congress has done all it could in the last 3 years or so? And I know this is beyond your purview, but do you think we have done all we can in terms of fiscal policy in this institution to actually promote growth in the country?

Ms. GALANTE. Rather than answering that question, I would say I think there is more that Congress could do for FHA in terms of giving us some additional authority that would help us do our jobs better.

Mr. HIMES. Fair enough. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thank you, Ms. Galante, for being here today and for your testimony. I want to kind of follow up on a comment you just made about what could Congress do for FHA. We are obviously very concerned about the numbers, the direction. I know that back in 2009, you had mentioned that you would like to—that the outlook for FHA was a concern of yours, but that the numbers today I think as we look at them do draw much more—deserve more scrutiny and questions to be asked. And you mentioned that if Congress would give FHA flexibility, I can't remember the exact terms that you used. Do you think that FHA would be better served from being outside of HUD as a standalone agency rather than under HUD and under its purview?

Ms. GALANTE. I think there are tools that FHA needs. I don't think that those tools relate to whether we are inside or outside of HUD. So there is no reason, from my view, that in order to access those tools, we would need to be outside of HUD. We are closely aligned with HUD and its mission, and there is no reason why that would need to change in order to give us the kinds of tools that I talked about, including better authority to go after lenders and terminate lenders when they are not doing the right thing and following our rules to being able to make emergency decisions without going through the full rulemaking process. Those are tools that could be given to us as examples that would be very, very useful.

Mr. STUTZMAN. Could you describe that relationship with HUD a little more? What is HUD's involvement in your day-to-day operations and how do they influence decisions at FHA?

Ms. GALANTE. The Secretary of HUD—as the Commissioner, I report to the Secretary of HUD, so it is part of HUD. We have separate accounting for the Federal Housing Administration, but our staff all follow the same rules that are part of the—

Mr. STUTZMAN. So if they were separated, what would change?

Ms. GALANTE. I think it depends on what people would impose or change specifically, right? There is not just—you are either in or you are out. You have to say what else would you be talking about?

Mr. STUTZMAN. I guess I am trying to find out, does HUD influence FHA in certain decision-making, or if you are standalone and you could use some tools, some flexibility with other tools, how would that be, how would that change things or make things work better?

Ms. GALANTE. Again, the main thing about being inside HUD is that we report up to the HUD Secretary. So that's—

Mr. STUTZMAN. What does that matter? Does that change the way that you handle your decision-making? Does it—I guess, if FHA were a standalone with tools, would we serve the housing industry better and would we serve the taxpayer better?

Ms. GALANTE. I would just say, I think within HUD and working with the HUD Secretary, there is no reason to change that. We could have some of these tools that would help us, as the fund and as an agency do an even better job, but I don't see any reason why it would be necessary to do that outside of HUD.

Mr. STUTZMAN. Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. Would you yield back to the chairman?

Mr. STUTZMAN. Yes.

Chairman HENSARLING. In the seconds remaining, and as a sign of respect to the gentleman from Connecticut, I wanted to respond to something that he said, and that is the accusation that Republicans were encouraging a violation of the law with respect to the debt ceiling. The debt ceiling is the law of the land until it is changed. And many of us believe that the specter of default on sovereign debt should never happen, it is unthinkable, and that is why House Republicans have passed the Full Faith and Credit Act to make sure that this never happens. I don't recall having any Democrats support that to take that nuclear option off the table. I hope perhaps one day they will support it. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Illinois, Mr. Foster, for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman. Ms. Galante, I want to echo Representative Himes' comments. I have profound respect for you and every one of the talented people who choose to spend a fraction of your life in service to the people of the United States.

It makes a big difference whether the housing operation in this country is well run or not. We are having a hearing about a $1.7 billion capital shortfall. In the financial collapse at the end of the Bush Administration, families in America lost $16 trillion of household net worth, two-thirds which was a drop in the value of their house at the collapse of the housing bubble, that is a factor of 10,000. So however many hearings you think it is worth having on this subject now, we should have 10,000 times more hearings on the incompetent management of our economy that led to the $16 trillion drop in household net worth.

And we heard also about your $150,000-a-year salary, well, that's 10,000 times smaller than the subject of the hearing today. And so the difference that you make whether you do your job well or not is much larger than your direct compensation.

I would also remind Members on both sides of the aisle that during the last Republican default crisis, family net worth dropped by $2.4 trillion, that was the drop the last time we went up to the cliff. Could you please hold up your page 2 graph again, I have a couple of questions on that. So you have those colored, now the red—some are red and some are blue. Does that indicate the political party that was in charge when those mortgages were indicated?

Ms. GALANTE. Actually, that's not what it is supposed to indicate, no.

Mr. FOSTER. So it is an accident that the party normally thought of as the blue party was responsible for the blue ends of the bar graph, that is interesting.

Is it fair to think of the approximately $2 billion shortfall we are talking about as the difference between the $41 billion deficit that you are facing because the mortgages originated under Republican-appointed regulation, and roughly 37 billion that have been recovered since Democrats have taken back control? Is that a fair statement of the difference?

Ms. GALANTE. It is absolutely true that the legacy books that are causing us the substantial problems are from 2006 to early 2009.

Mr. FOSTER. There was also talk about accountability. So if you look at the fact that the party that was responsible for running up all the red bar graphs was, in fact, removed from power, I think there is accountability, and the fact that you are a Presidential appointee is a reflection of that accountability.

Now, I want to change subjects a little bit towards what rules could have been in place that might have prevented the disaster of 2001 to 2009? And there is a suggestion that has been made—there are some research papers on what are effective countercyclical capital requirements for you. Are you familiar with this general line of research?

Ms. GALANTE. A little bit, yes.

Mr. FOSTER. Yes. And so the idea would be that as a protection of the taxpayer against investing into a housing bubble effectively, that you would look, have some effort to estimate market conditions. And when you identified that you are investing into a bubble that you would hold more capital, hold more loss reserves, or—and/or tighten the credit box or some combination of both of these effectively asking the homeowner to hold more capital reserves against this. I was wondering, this is something—first of all, would this, had this sort of rule been in place, would that have mitigated your financial difficulties today?

Ms. GALANTE. I think the challenge with that is you could actually be worsening the crisis by making it more difficult to increase downpayment requirements for—on individuals, for example, in a crisis as—

Mr. FOSTER. These are requirements that would have tightened the credit box during the bubble years. For example, looking at the recent appreciation housing values as one of the metrics for tightening the credit box.

Ms. GALANTE. So when times are "good," yes.

Mr. FOSTER. Right, what we are talking about is an automatic punch bowl retractor?

Ms. GALANTE. Yes. Sorry, I thought you were talking about the reverse.

Mr. FOSTER. It is the countercyclical principle on the upswing. There was an American Enterprise Institute conference on that subject this summer, which I thought presented a number of good ideas. I was just wondering if that was under serious consideration, or if you might be willing to endorse some variant of this?

Ms. GALANTE. I would certainly have to look into that more.

Mr. FOSTER. Okay. Thank you again for your service.

Ms. GALANTE. Thank you.

Mr. FOSTER. I yield back.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from California, Mr. Royce, for 5 minutes.

Mr. ROYCE. Yes, I would like to go back to an issue that I think Mr. Sherman from California raised with you, and Mr. Mulvaney, to try to get your position actually nailed down on Richmond, California's proposed use of eminent domain to seize performing mortgages.

A number of times over the last year, I have sent letters, and I know Mr. Miller and Mr. Campbell, and my colleagues in the Senate as well have tried to get the Administration to definitively come out and just state your position on the proposed use of eminent domain to seize mortgages. And my question is, if you would make that statement?

Ms. GALANTE. Yes, I appreciate you asking this question again, because I think the former times that I have gotten asked it, it was the end of questioning as opposed to the beginning which makes it a little hard to give a full answer. But what I have been trying to say here is that we do believe that eminent domain authority in general is a local and State authority and it needs—

Mr. ROYCE. Well—

Ms. GALANTE. May I just finish this? They need to be able to make their decisions and this needs to be played out over time in terms of what impact, if any, it will ultimately have on lending. So I—

Mr. ROYCE. Hold on, hold on. The question that you need to answer, if you think it through, is will the FHA insurance fund be counted on or not? Do we have a position where the FHA insurance fund cannot be counted on by the investment fund mortgage resolution partners in Richmond or elsewhere to help insure refinance mortgages that are seized through eminent domain? This is a question that pertains to your decision.

Ms. GALANTE. Yes. And what I was getting to is that when we see how this plays out, and we don't know exactly what FHA would be asked to do in any particular given situation under the use of eminent domain, when we see that, if we need to issue additional guidance, FHA will do so. But we don't even know exactly what these various programs will look like at any given time.

Mr. ROYCE. No, we know exactly what the programs look like. This isn't a hypothetical. We know what the plan is. MRP has made their presentation in California, they made it in Nevada. Yes, there could be legal challenges, and they may or may not be successful, but why do we need to allow the process to reach that point? You can solve a lot of confusion by stating whether or not the FHA will be available to refinance any mortgages seized under MRP's eminent domain plan, that is the question.

Ms. GALANTE. Again, we do not believe we understand the exact contours of any of these. There are different proposals and different communities, and those proposals could be applied differently.

Mr. ROYCE. Okay. The FHFA has made a very strong statement for a reason—they stated that they would restrict or cease business activities within the jurisdiction of any local authority or any State employing eminent domain to restructure mortgage loan contracts. The question is, why FHA won't do the same?

Ms. GALANTE. So—

Mr. ROYCE. Why will you not state without a doubt that FHA will not be used to refinance these seized mortgages?

Ms. GALANTE. Again, to be clear, we have made our statement, which is that we will look at and see how these programs play out.

Mr. ROYCE. Okay.

Ms. GALANTE. Whether or not there is a necessity for us to issue any—

Mr. ROYCE. FHA refinance up on the screen there is clearly part of the program, that is what is in circulation. And getting back to an earlier point, because some of us were concerned about over-leverage as we get back to the issue of the implosion of the economy brought on by overleverage. One of those issues was the role that Congress played. And yes, the role that was played by this committee and on the Senate side in allowing the over-leveraging, 100 to 1 by Fannie Mae and Freddie Mac. And when legislation was brought by me and others to the Floor to try to allow the regulatory committee to control it, it was opposed by that side of the aisle. So, there is a little bit of revisionist history going on here.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from Ohio, Ms. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman. Thank you ranking member, and again to our witness, thank you for coming.

Before I ask a few questions, let me just start by saying I think we have become all too comfortable with loudly interrupting and talking over our witnesses. And while that may sometimes be the way it appears that we operate, I think today we took it a little too far, "faceless government worker, questioning your public service."

So let me use three words that I was always taught, and they are very powerful words: "I am sorry." I join my colleagues, Representatives Cleaver and Himes, in extending their apologies because sometimes I think we forget. When we talk about challenging your commitment to public service and putting that in question today, I find it very ironic that some of my colleagues who question your integrity are the same people who furloughed some 800,000 Federal employees, which cost the government some $24 billion, and certainly reduced job growth of some 120,000 jobs because of our shutdown.

Now, how does that tie in today? I think when we look at the housing market and we look at growth and we look at the economy, and we look at jobs, there is direct linkage. But my memo said that today we were going to talk about and ask you questions so we could share and learn more about the FHA's recent announcement about the MMIF.

I read something that I would like for you to answer for me if this is factual in truth, because in hearings, I think we have an obligation to the people who are here and to America to speak the facts and the truth, and then look at how we dissect that to come to some end resolve.

What I have before me says that the Federal Credit Reform Act of 1990, or FCRA, requires that at end of each fiscal year, and as part of the closing annual financial statement, every credit agency, including the FHA, must have sufficient reserves to cover all anticipated loss. For FHA, this requirement means that the MMIF must have sufficient reserves to cover the amount that would be needed to meet all expected claims over the next 30 years, if FHA closed its doors tomorrow and had no new business to offset those claims, such as an appropriation is not a bailout. Would you agree with that statement?

Ms. GALANTE. I agree.

Mrs. BEATTY. Thank you. We have heard it said loudly that this would be a bailout. So, thank you for clarifying that it isn't a bailout.

I guess my next set of questions would be, would you say that there has been an economic shock this year by the fiscal cliff, or sequestration, or the government shutdown, or the threat to default on our Nation's debt, would you say that impacted the fund's performance in any way?

Ms. GALANTE. To be clear, the shutdown caused economic harm in general, according to economists. I can also tell you that in that very short period of time while FHA kept its doors open and continued to ensure mortgages, we did see a substantial drop in our application volume, as did other partners or other agencies given the lack of confidence in home buying, for example, during that period of time.

Mrs. BEATTY. Lastly, let me just make a comment because we have had so many comments that have attacked the FHA. I think the American people also like to hear good or positive news, especially when we are talking about housing and putting a roof over their head. So let me just say I am from the great State of Ohio, and in my district, through the American Recovery and Reinvestment Act in 2009, through your operation, we were able to provide housing credit assistance, and that tax credit assistance and the tax credited change was a way to offset declining investors interest in housing tax credits, and that was done by some of my Democratic colleagues, and I wanted to thank your office for working with us on that.

Ms. GALANTE. Thank you.

Mrs. BEATTY. Thank you, and I yield back.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. I want to be clear at the outset that FHA has helped a lot of my constituents, first-time home buyers and low-income home buyers, to achieve the American dream of homeownership. It has been incredibly helpful for them. And so I don't want to underestimate how important the program has been for people who live in central and northern Wisconsin. It has been a very helpful program.

I think you picked up a little bit of concern on our side of the aisle, and I think our frustration here is that whenever we have testimony, we continually bring up concerns about the capital reserve ratio. It hasn't been that, we are concerned about bailouts. And it seems that every time we get testimony from the agency, we are told that it is sunshine and roses and tulips and unicorns; everything is great. And we look at the numbers and say, that is not true. We think it is far worse than you are telling us. And it is always no, no, no, no. It is all fine. And lo and behold, we were right, our concern was well-warranted because we now know that we are going to have almost $1.7 billion going from Treasury to FHA. And I know that you said it is not a bailout. First of all, would you agree it is actual money, this is an accounting. We have actually had $1.7 billion go from Treasury to FHA; that is correct, right?

Ms. GALANTE. It all stays in Treasury accounts, but yes.

Mr. DUFFY. But it has been moved to FHA, right?

Ms. GALANTE. To our accounts at Treasury, yes. It is intergovernmental.

Mr. DUFFY. —balance sheet, the transfers has been made?

Ms. GALANTE. Correct.

Mr. DUFFY. And so these are real dollars, yes?

Ms. GALANTE. Yes.

Mr. DUFFY. Okay. And I just want to be clear on the bailout. If this isn't a bailout, what do you consider a bailout?

Ms. GALANTE. Congressman, let me say two things, because I do think this whole conversation about bailout or no bailout is really beyond the point. I want to go to the fact that your earlier statement about we have said its roses and then it is not, what we have been saying all along is that we have an independent actuary, and we have an independent budget reestimate that is made by the budget process. And as a result of changes in condition and changes in portfolio, those numbers change. And we have always been honest about that.

In fact, the conversation we are having here today, we had this conversation when the President's budget came out and said that we were looking at a $943 million shortfall. I really just want to get this on the record because the only difference between then and today is that our volume was a little bit less in the last quarter than we had anticipated as part of the President's budget. I admit that circumstances change, and that is what caused the additional—

Mr. DUFFY. But this underscores the point of the testimony that we always get. It is a bailout. If it looks like a bailout, it walks, it quacks, it is a bailout, just call it a bailout. Let me ask you this: What are the terms of repayment of the $1.7 billion?

Ms. GALANTE. This is exactly why it is not a bailout, because again, this is all within the government agency—

Mr. DUFFY. What are the terms of the repayment of taxpayer money of $1.7 billion?

Ms. GALANTE. The terms are every nickel we ever earn goes back to the Federal Government.

Mr. DUFFY. No, no. So are there terms of repayment? No, you don't have to repay it, do you? It is a bailout. There might be a point in the future where we make a little bit of money and we turn it over. But there is no requirement that you pay the $1.7 billion back to the American taxpayer, not at all. And so, I think the transparency and honesty, stop splicing words, this is a bailout, call it what it is.

Ms. GALANTE. No, what I am saying is—

Mr. DUFFY. Repay it to a taxpayer.

Ms. GALANTE. We have prepaid on this, we pay every year on an ongoing basis.

Mr. DUFFY. I only have 15 seconds left. In the PATH Act, we discussed a risk-sharing pilot program, is that something you would consider at FHA, a risk-sharing pilot program?

Ms. GALANTE. I would just say that I think it is worthy of looking at, risk sharing, how it is structured, counterparty risk, there are a lot of challenges in risk sharing but we certainly are willing to look at the parameters.

Mr. DUFFY. I yield back.

Chairman HENSARLING. The time of the gentlemen has expired, and to notify our very patient witness, we anticipate two more Members to ask questions. The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman. Ms. Galante, thank you very much for your presence here today. Thanks to the FHA for, I believe 40 years ago this very month, enabling me to buy my first home, and thank you as well for your kind comments about both my role and that of Congressman Fitzpatrick in the earlier effort to reform the reverse mortgage market. Indeed, I would like to flip that around a little bit and take this opportunity to express my gratitude to Congressman Fitzpatrick for his exceptional advocacy, and to the members of the industry, the reverse mortgage industry, who really stepped up to be a constructive part of this, and to you personally as well.

I don't happen to think your reputation as a public servant needs a whole lot of defense, because I frankly think it speaks for itself. And if my experience working with you on the Reverse Mortgage Reform Act is any indication, it is beyond reproach and exceptional, and I thank you for it.

I thank you as well for the speedy way in which the agency moved to implement the Reverse Mortgage Reform Act. I think it helps a lot and speaks volumes about the FHA. I think sometimes here we, to coin a verb, "complexify" things beyond what they need.

So let me see if I can reduce this to its basic elements. Do I understand correctly, Ms. Galante, that in the table on page 8, as Congressman Sherman was getting at, we could say that the accounting transfer was triggered and/or required almost entirely as a result of the performance in the HECM program?

Ms. GALANTE. That is correct.

Mr. HECK. And is it also true that the accounting transfer of $1.7 billion was calculated based on data prior to the enactment of the Reverse Mortgage Reform Stabilization Act and its implementation?

Ms. GALANTE. That is a little more difficult, because I would just say that the 1.7, there is an element of the receipts that are a little bit less, as I was saying, to an earlier question.

Mr. HECK. And when will an actuarial projection be predicated on a full recognition of the implementation of the Reverse Mortgage Stabilization Reform Act—I am getting the title screwed up, but I think you know what I am referring to.

Ms. GALANTE. Just to be clear, the next time you will see numbers like this is when the President does the reestimate that will be probably, the dates shift a little bit again, partly because of the government shutdown, but I would expect though reestimates to be available in February or so of next year.

Mr. HECK. And to what degree will that reflect any experience for implementation?

Ms. GALANTE. It will reflect the projections of what the future experience will be, yes.

Mr. HECK. So do I also understand correctly that when you all make money, you transfer back to the Treasury; is that correct?

Ms. GALANTE. That is correct.

Mr. HECK. Have you done that in the years leading up to the Great Recession?

Ms. GALANTE. Yes.

Mr. HECK. Can you give me some kind of a range of estimate about how much money?

Ms. GALANTE. I don't have that, we keep it all in the capital reserve. The capital reserve went well above the 2 percent up to I think 8 percent in earlier years.

Mr. HECK. It does not literally get transferred to other accounts?

Ms. GALANTE. Again, they are all sitting at Treasury, all these accounts are at the Treasury.

Mr. HECK. Okay. So just to summarize, and please do correct me if I am oversimplifying, the requirement for the accounting transfer was triggered, in large part, by the experience in the Home Equity Conversion Mortgage Program, a problem you identified and sought legislation from this Congress, which responded with your able assistance, and which you immediately implemented, and projections about how FHA's balance sheet will be affected by all of that are not going to be made available until some time in the winter or spring reflecting the corrections to that single program that was dragging you down. Do I have that all correct?

Ms. GALANTE. Yes, you do, sir.

Mr. HECK. I think that about says it all. Thank you again for your service. With that, Mr. Chairman, I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Ohio, Mr. Stivers, for 5 minutes.

Mr. STIVERS. Ms. Galante, I appreciate your willingness to be here today, and I appreciate what you do on behalf of the Federal

Government at FHA. What I want to look at is how FHA might be able to improve its performance so that any additional infusion of capital—taxpayer capital, whether you want to call it a bailout or accounting transfer, it doesn't matter what you call it, I want to try to figure out how we can improve your performance to avoid it in the future.

You said during your testimony that you thought FHA had taken every reasonable action to improve its risk management. And so, I want to look at a few areas. You talked about REO real estate that you own. Are you familiar with the GAO report from June of 2013—

Ms. GALANTE. Yes, I am.

Mr. STIVERS. —that reviewed your practices? And on—page, the page number is not here—in one of the highlights here, it said that if you had dealt with your dispositions on timelines the same way as the Government-Sponsored Enterprises, both Fannie and Freddie, that you would have been able to save as much as $600 million a year in your cost such as taxes, homeowner association fees, maintenance fees, and others, and you would have increased your proceeds by up to $400 million. It has taken you about a year, taken them about 200 days to dispose of their REO real estate.

Tell me what you have done with that to improve your performance going forward. I am not here to blame you, I just want to see how we are going to fix it.

Ms. GALANTE. Yes, so just to be clear, we changed how we do government contracting for those who take responsibility for—

Mr. STIVERS. Have you seen results from that yet?

Ms. GALANTE. So, yes. Let me just give you one example. We now do an REO alternative disposition called Claims Without Conveyance of Title, so not requiring the property to come all the way back to us and it enabling our—

Mr. STIVERS. Can I ask you, instead of just one example, have you seen your average length of disposition shorten in any significant way, or do we not know yet?

Ms. GALANTE. Again, in this Claims Without Conveyance of Title—

Mr. STIVERS. That will speed things up. I am looking for how it moves your average.

Ms. GALANTE. Yes, so again our recoveries have improved by more than 10 percent on our—by these new recovery strategies that we have been going through, both REO and alternatives to REO disposition.

Mr. STIVERS. I guess I just ask that you to continue to monitor that.

Ms. GALANTE. Absolutely.

Mr. STIVERS. And move forward as quickly as you can.

I would like to you look at the slide up there which shows that your capital ratio has continued to worsen, and you did talk about premiums and some things had you done. Let's move to the next slide really quickly, no, next slide.

So there were some things that you could have done to change your premium, both your up-front premiums and your annual premiums, and let's go to one more slide. Look at what has happened to interest rates over time, we are at still with an uptick over the last few months pretty historically low interest rates. You have the ability to—go back one slide, to increase your annual fees by another 25 basis points which would be a rounding error on the amount that interest rates have come down over the last few years. Why have you chosen not go ahead and max that out and require less taxpayer infusion, whether you call it a bailout or you call it something else?

Ms. GALANTE. We have spent an enormous amount of time balancing, bringing the fund back as quickly as possible with ensuring continued access to credit. And, by the way, just when you take a look at what happened when we made our latest increases in June and not just premium increases, but our policy changes, you saw a huge amount. Our application volume dropped off by 50 percent.

Mr. STIVERS. And my time is limited. Let's go back to that again.

Ms. GALANTE. By the way, I can't see this.

Mr. STIVERS. When you look at how much interest rates have come down, and we are talking about rounding errors for those 25 basis points. And it could have helped you significantly and I would ask you to look at that again. And this is, I think, the fifth time you have come to testify before the committee in my 3 years here, and every time I ask you, so I am going to ask you again, why hasn't FHA instituted risk-based pricing yet, being that you have had the authority since 2010?

Ms. GALANTE. Again, I believe I said this before that FHA believes that the way we do pricing and the way we do risk-based underwriting but not risk based pricing and we do that because we think that is in the best interest of the borrowers and access to credit. And again, we are always balancing—

Mr. STIVERS. I have limited time. I would argue that you should do both. Thank you for your time.

Ms. GALANTE. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. There are no other Members in the queue, so I would thank Ms. Galante again for her testimony and patience today.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place her responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

A P P E N D I X

October 29, 2013

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

Written Testimony of Carol Galante
Assistant Secretary for Housing/Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development (HUD)

Hearing before the House of Representatives
Committee on Financial Services

Tuesday, October 29, 2013

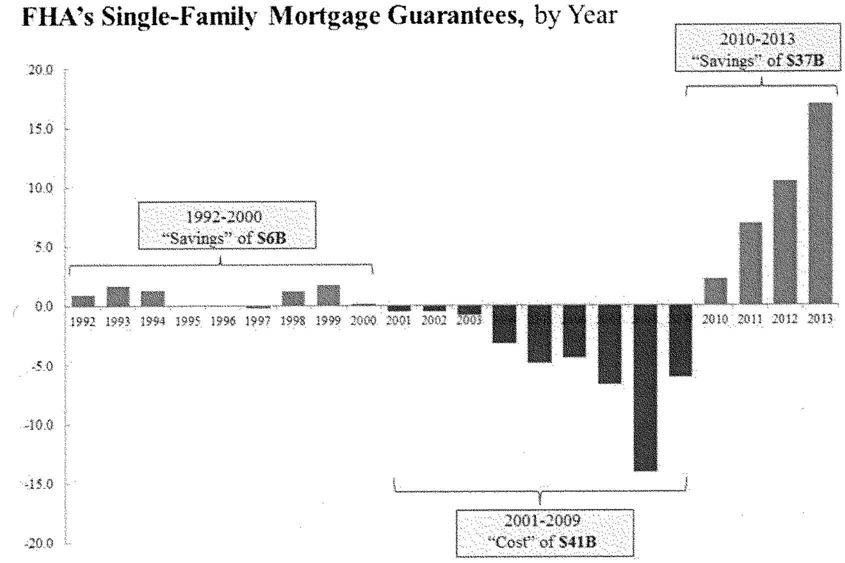
Thank you, Chairman Hensarling and Ranking Member Waters, for this opportunity to testify on the work of the Federal Housing Administration (FHA).

Established in response to the Great Depression, the FHA has served a critical two-part mission in support of the housing market and broader economy by facilitating access to sustainable mortgage financing - particularly for underserved borrowers - and acting as a stabilizing countercyclical force in both the national as well as regional economies during times of crisis or uncertainty. Throughout its history, when the private market would not or could not provide access to mortgage credit to particular persons or under difficult certain economic conditions, FHA made borrowing possible. And for nearly 80 years FHA has made the American Dream a reality for more than 40 million families – including 40 percent of all first-time homebuyers and 50 percent of all African-American and Latino homebuyers.

Since 2009, FHA has helped nearly 7 million families become homeowners or refinance into a more affordable home loan –aiding in the stabilization and ongoing recovery of the housing market. When the recent recession pushed our economy to the brink of collapse, FHA stepped in to provide access to mortgage financing as the private market retreated. To keep mortgage credit flowing – supporting and stabilizing communities and countless industries – FHA's Single Family program more than quadrupled its activity, accounting for over 20 percent of the market at the peak of the financial crisis. Economist Mark Zandi has noted that absent FHA's presence in the market, home prices would have declined an additional 25 percent during the recession. In the face of the worst financial crisis since the Great Depression, FHA made it possible for the housing sector – crucial to our nation's economic engine – to continue functioning.

Playing this role during the Great Recession placed considerable stress on the Mutual Mortgage Insurance Fund (MMIF). The capital reserve ratio of the MMIF has been below the statutory two percent threshold since 2009, with losses from the 2007 to 2009 legacy books and the Home Equity Conversion Mortgage program (HECM) responsible for the most severe strain.

Current Estimates of the Federal Budgetary Impact of FHA's Single-Family Mortgage Guarantees, by Year



Source: CBO analysis of President's Budget for Fiscal Year 2014

Due in large part to the stress placed on the Fund from the HECM program and the aforementioned legacy loans, on September 27, 2013, I notified Congress that FHA would require a mandatory appropriation in order to ensure that at the end of FY 2013 the MMIF had sufficient funds in its capital reserve account to pay for all expected future losses. This mandatory appropriation of $1.68 billion is not an indication of FHA's cash position or its ability to pay claims on outstanding loans insured by the MMIF. Rather, it is a function of FHA's obligations under Federal Credit Reform to maintain sufficient reserves to pay all expected losses as measured each year at a single point in time, and therefore does not account for the effect of future endorsements. Today, FHA has over $48 billion in its financing account.

The calculation that determines the budget re-estimate is based on assumptions about loan performance and recoveries made prior to February 2013. This calculation does not consider the real time performance of the Fund, which has been making steady improvements since that calculation, as a direct result of the actions this Administration has taken. These actions are described below, were outlined in our Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund, and have been mentioned in prior testimony before this Committee.

Since 2009, even before the independent actuary reported that the capital reserve ratio had fallen below the mandated 2 percent, FHA took a number of steps to stabilize and strengthen the Fund and protect American taxpayers while continuing to support the housing market. Changes to FHA's lender oversight and credit policies made since 2009 have yielded substantial improvements in the quality of new loans endorsed by FHA, and premium increases have ensured that FHA is priced appropriately for its risk. Throughout FY 2013, FHA has executed on additional opportunities to reduce the impact of poorly performing legacy loans severely impacted by the recession to the Fund, providing greater assistance for distressed borrowers as they seek to recover and find meaningful assistance in dealing with their delinquent loans. With a majority of FHA's projected losses attributable to loans insured from 2007-2009, these additional steps to maximize recoveries through loss mitigation and asset management have improved the long term trajectory of the Fund.

Counterparty Risk Management and Lender Enforcement

One of the first things this Administration did upon taking office was to take strong actions to improve FHA's monitoring and oversight of lenders. This has included substantial improvements to risk analysis systems and procedures, and policy changes to focus resources on the areas of FHA's business which pose the greatest potential risk to the MMIF. These efforts have resulted in lenders being withdrawn from FHA programs, improvements in lender compliance with FHA requirements, and a number of settlements with lenders and servicers for violations of FHA origination or servicing requirements.

Yet, it remains important that we continue to improve and refine the rules of the road for FHA lenders. That is why this year FHA issued a mortgagee letter implementing a Lender Insurance (LI) Lender Indemnification Final Rule. This guidance, which is part of a larger effort to ensure that our lending partners have clarity with respect to FHA programs, establishes better and more consistent monitoring of LI lenders and outlines clearer parameters upon which HUD will require indemnification for loans originated by these institutions.

Additionally, we have been concerned of late with a number of online and print advertisements that proclaim the supposed ease of obtaining an FHA-insured loan following a foreclosure. While FHA has taken a number of proactive steps in the past few years to clarify its requirements regarding lender advertising and to enforce those requirements aggressively, we determined last year that it was necessary to address the issue of post-foreclosure advertising specifically. Therefore, on January 25, 2013 FHA issued a reminder to its industry partners that advertisements that imply that little or no qualification criteria are necessary to obtain an FHA loan are untrue and unacceptable, and that FHA will not hesitate to take action within its authority to enforce requirements related to lender advertising, including sanctions by HUD's Mortgagee Review Board and/or referral to the HUD Inspector General or the Consumer Financial Protection Bureau (CFPB).

Credit Policy
Since 2009, we have also engaged in an ongoing effort to strengthen credit policies for FHA borrowers. First and foremost, FHA fulfilled the implementation of Congress' elimination of seller-funded down payment assistance programs which cost the MMIF more than $15 billion in economic value. Further, we enacted increased down payment requirements for borrowers with credit scores below 580. The long-term positive impact of these two credit policy changes cannot be overstated. The 2005 – 2008 vintages, accounting for less than 15% of total originations over the last 30 years, are projected by the Actuary to contribute more than one-third of total credit losses to the Fund. Of those losses, loans with credit scores below 580 and/or seller-funded down payment assistance will have accounted for 44%. Additionally, we are actively working to finalize, following a re-proposal, regulations to reduce the amount of allowable seller concessions that increase risks to FHA arising from inflated appraisals.

Late last year, FHA announced several additional changes which continue the work of strengthening credit policy while supporting the ongoing economic recovery, maintaining access to mortgage financing for creditworthy borrowers, while also taking steps to reduce FHA's total market share. These steps include requiring manual underwriting for borrowers with credit scores below 620 and debt to income (DTI) ratios over 43 percent, enhancements to FHA's TOTAL Scorecard, and a proposed increase in the required down payment for borrowers seeking loans in excess of $625,500. Taken together with the other measures outlined above, as well as those detailed in Appendix A of FHA's Annual Report to Congress[1], these steps will ensure that home buyers using FHA-insured financing are capable of meeting their mortgage obligations and will not put undue stress on the Fund.

Increased Revenue
In addition to the improvements made to the quality of new endorsements, we have also made the difficult choice to increase mortgage insurance premiums for FHA-insured loans multiple times in the past four years. Since 2009, FHA has increased premiums five times – the most recent increase effective April 1, 2013. Combined, the premium increases made since 2009 have yielded more than $10 billion in additional economic value for the Fund to date. These increases have not been undertaken lightly, and FHA has been careful to balance changes to pricing to improve the outlook of the Fund with its countercyclical role of providing liquidity and access to credit in the midst of the recent crisis and ongoing recovery. Today, particularly with interest rates rising, it is possible that we have reached a "tipping point" with respect to FHA premiums, and as we continue to seek a balance between strengthening the Fund and ensuring access to credit,

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[1] Available at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgrroom

we must assess whether FHA premiums are set to appropriately account for risk to the Fund without making the cost of credit prohibitive for qualified homebuyers.

Additionally, effective with case numbers assigned on or after June 3, 2013, FHA ended a policy of cancelling required mortgage insurance premiums (MIPs) on loans for which the outstanding principal balance reached a level of less than 78 percent of the original principal balance. Under that policy, FHA remained responsible for insuring 100 percent of the unpaid principal balance of a loan for the entire life of the loan – a period often extending far beyond the cessation of MIP payments. As written, the timing of MIP cancellation was directly tied to the contract mortgage rate, not to the actual loan LTV. The original policy was put in place at a time when it was assumed that home values would not decline. Today we know that LTV measured by appraised value in a declining market can mean that actual LTVs are far higher than amortized mortgage LTV, resulting in higher losses for FHA on defaulted loans. Analyses conducted by FHA's Office of Risk Management projects lost revenue of approximately $10 billion in the 2010-2012 vintages as a result of the old cancellation policy. The same analyses also suggest that 10%-12% of all claims losses will occur after MIP cancellation. This policy was reversed in a Mortgagee Letter published on January 31, 2013. The new policy of collecting premiums based upon the unpaid principal balance of FHA loans for the entire period during which they are insured permits FHA to retain significant revenue that was previously being forfeited prematurely, better protecting the MMIF.

Loss Mitigation and Asset Management

In FY 2012, the independent actuary projected that nearly $60 billion in claim costs to FHA were from seriously delinquent loans insured between 2007 and 2009 that were expected, according to their model, to go to claim by the end of FY 2014. As a result, FHA has made it a priority to reduce the severity of losses associated with these loans. Because of the demonstrable positive impact for both borrowers and the Fund resulting from those efforts FHA will continue its targeted policy and programmatic efforts in these areas over the next several years.

Beginning in FY 2012, FHA began executing on an overall asset management strategy aimed at ramping up REO alternatives. REO alternatives (primarily short sales) have comprised about 15%-20% of total dispositions since 2010, yielding average loss severities about 20% lower than REO. In June 2012, FHA also unveiled a revamped Distressed Asset Stabilization Program (DASP), an REO alternative that improves Fund performance while giving distressed homeowners another chance to retain their homes after FHA's loss mitigation waterfall has been exhausted. These and other actions have had a measurable effect on the portfolio as loss severities have fallen by 26 percent since their peak. In addition, compared to March of 2012, serious delinquencies were down in March 2013, with non-seasonally adjusted serious delinquencies dropping below 9% for the first time in over a year, showing that FHA and the market have made some progress in clearing the backlog of seriously delinquent loans previously withheld from a final disposition.

FHA expects further gains on this front through a number of initiatives:

Streamlining of the FHA Short-sale Policy

Although FHA is deeply committed to providing loss mitigation alternatives to borrowers which permit them to retain their homes, home retention is simply not an option for some borrowers. For these borrowers, pre-foreclosure sales (short-sales) offer a more favorable option to transition out of their homes. This enables both FHA and borrowers to avoid the costs and adverse impacts of the foreclosure process.

Therefore, effective October 1, 2013, FHA has put in place a streamlined pre-foreclosure sale policy which removes certain barriers for borrowers to obtain a short sale on an FHA-insured mortgage. This change is expected to increase the number of defaulted loans that end in short sales rather than in foreclosures. Because losses from short-sales are substantially lower than from the traditional FHA REO process, the shift of greater numbers of distressed homeowners to short-sale dispositions rather than foreclosures is anticipated to yield better results for the MMIF while allowing distressed borrowers to start anew without having to go through the difficult and costly foreclosure process.

Claim Without Conveyance Pilot Program

In FY2013, FHA expanded a pilot in which properties secured by non-performing FHA-insured loans are offered for sale by the lender who has completed the foreclosure process. At a reserve price slightly below the outstanding unpaid principal balance of the loan, the properties are sold to third party purchasers without ever being conveyed to FHA. This method of disposing of these properties has improved recoveries to the Fund as compared to placing a property through the REO disposition process, largely due to the elimination of carrying costs associated with preserving, managing, and marketing an REO property.

Proactive Strategies to Further Improve Recoveries

In addition to the policy and programmatic changes outlined above, FHA will also take several innovative and proactive steps to increase utilization of loss mitigation options and reduce unnecessary asset disposition losses. First, FHA is positioned to launch a large-scale proactive marketing campaign to promote modification and short-sale strategies for delinquent borrowers. This effort is expected to increase utilization of these programs, which will permit more borrowers to become aware of and take advantage of these opportunities, while reducing foreclosures and decreasing associated losses for FHA. In addition, FHA will also pursue more creative strategies to dispose of REO properties in markets where traditional asset disposition methods yield net negative recoveries for FHA. This approach is anticipated to both save money for FHA on unnecessary losses as well as contribute to community stabilization initiatives in cities hit hard by the recession.

As a result of the changes outlined above, which have yielded higher quality loans and reduced loss severities, and combined with the large volume of current loans, for FY 2013, FHA was projected to generate approximately $18 billion in receipts. This included a pro-rated value of $3 billion based on revenue generated from the new premium increase that went into effect April 1, 2013, and reversal of the MIP cancellation policy. However, as interest rates rose through the end of FY 2013, following the trend in the broader housing market, actual FHA endorsement volume fell below the budget estimates for that book year, resulting in actual receipts of over $17 billion.

The FY 2014 budget projects FHA receipts of almost $13B, even as FHA market share and loan volume continue to be reduced.

FY 2013 MMIF Budget Re-estimate
The Federal Credit Reform Act of 1990 (FCRA) requires that at the end of each Federal fiscal year, and as part of closing annual financial statements, every credit agency must have sufficient reserves to cover one hundred percent of anticipated future losses, as determined by performance and economic conditions. When the President's FY 2014 budget proposal was released earlier this year, it was estimated that while FHA had significant liquid assets, $33.1 billion at the time the budget was released[2] that it would be required to supplement its reserves to cover all expected losses for the next 30 years.

At the time the budget was released, it was clear that the potential for a mandatory appropriation to the MMIF was largely due to the existing reverse mortgage (Home Equity Conversion Mortgage or HECM) portfolio, but that the final outcome would be a function of receipts generated by the FY 2013 book of business.

Impact of legacy HECM loans on the MMIF Re-estimate
The HECM product, particularly as it had been structured prior to summer 2013, is sensitive to borrower longevity, home prices, and economic conditions. Lower than anticipated home price appreciation substantially affected the expected performance of the portfolio. Further, changes to the ways in which borrowers utilize the HECM product shifted the risk profile of the program.

Originally designed to be used like an annuity, in recent years market circumstances and lender preferences have shifted greater numbers of borrowers to take full draws via the Fixed Rate Standard product. Thus, many borrowers are taking all of the funds available to them up-front and often do not have the resources necessary in later years to pay property taxes and insurance,

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[2] See Quarterly Report to Congress on FHA Single Family Mutual Mortgage Insurance Fund Programs, Quarter 3, 2013. Posted August 23, 2013. *Available at:* http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly

thereby triggering a default on the loan. Due to these changes in usage and performance, the budget estimates that the use of the HECM program results in a negative value of $5.249 billion and a disproportionately negative impact to the Fund.

FY 2013 Budget Reestimate: President's Budget Estimates vs. Actual

FY 2013 MMIF Budget Reestimate				FY 2013 Actual		
$ in millions	Forward Mortgages	HECM	TOTAL	Forward Mortgages	HECM	TOTAL
SOY Capital Reserve	$3,309	0	**$3,309**	$3,309	-	$3,309
- 2013 Negative Subsidy Receipts	$17,908	$268	**$18,176**	$17,079	$ 366	$ 17,445
- Interest on Investments	$14	$0	**$14**	$9	-	$9
- Liquidating Acct. Transfers	($10)	$0	**-10**	$ (16)	-	$ (16)
- Net Upward Re-estimate	($16,915)	($5,517)	**($22,432)**	($16,915)	($5,517)	**($22,432)**
Surplus (Deficit) in the Reserve to Finance Reestimates	$4,306	($5,249)	($943)	$3,466	($5,151)	**($1,685)**

In response to this, above and beyond the steps FHA announced with the release of the FY 2012 Report to Congress on the Health of the Mutual Mortgage Insurance Fund [3], FHA applied its limited authorities to take additional and immediate actions to better align the HECM program with its objective of enabling seniors to age-in-place while better protecting FHA from losses and reducing the likelihood of borrower defaults. While these changes significantly impacted consumer use of the program, the long-term health of the program and the Fund warranted aggressive steps to better protect FHA from losses and reduce the likelihood of borrower defaults. Ultimately, these actions are designed to ensure that new endorsements[4] of loans under this program better align the HECM program with its objective of enabling seniors to age-in-place.

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[3] *Available at:* http://portal.hud.gov/hudportal/HUD?src=/fhammifrpt

[4] For the duration of the government shutdown which ended on October 16th, FHA was unable to process new HECM endorsements

In administrative guidance dated January 30, 2013, FHA consolidated the Fixed Rate Standard program with the Fixed Rate HECM Saver product, resulting in a reduction of the maximum amount of funds available to a HECM borrower. And, with the support of Congress – in particular Mr. Heck and Mr. Fitzpatrick of this Committee, HUD was given authority to make additional critical changes to the program through mortgagee letter. Effective this fiscal year, these changes included:

- Changes to initial mortgage insurance premiums and principal limit factors;
- Restrictions on the amount of funds senior borrowers may draw down at closing and during the first twelve months following closing;
- Soliciting public comment on a requirement that all HECM borrowers undergo a financial assessment to ensure that they have the capacity and willingness to meet their financial obligations and the terms of the reverse mortgage; and
- Requiring borrowers to set aside a portion of the loan proceeds at closing (or withhold a portion of monthly loan disbursements) for the payment of property taxes and insurance based on the results of the Financial Assessment – for which FHA also solicited comment.

Additionally, in an effort to reduce losses associated with the conveyance and disposition of properties mortgaged with a HECM, FHA will issue new incentives for the estate executors of HECM borrowers to dispose of properties themselves rather than conveying them to HUD. Currently, executors are permitted to either sell such properties or convey them to HUD. Reversing the historical trend, over the past few years larger numbers of executors have been choosing to convey these properties to FHA rather than sell them, adding costs and reducing recoveries for FHA. By incentivizing the sale of properties by executors, FHA will be able to avoid property management, maintenance, and marketing costs associated with the REO disposition process, thereby reducing losses to the Fund on these properties.

However, despite these immediate actions and the assistance of Congress in facilitating a longer-term solution with regard to the HECM program, authority for the structural changes to that program were not finalized in time to impact the FY 2013 book of business. As with the FY 2007-2009 legacy forward loans, legacy HECM loans will continue to impact the estimated economic value of the Fund for some time to come.

Ultimately, the determination each year of whether a mandatory appropriation for the MMIF is necessary is a function of actual versus expected budget receipts at the end of fiscal year. These receipts are in turn based on volume projections in the President's budget which, as stated above, fell below budget estimates.

Outcome of FY 2013 Budget Re-estimate

Bringing the housing market from the brink of collapse to a place where it is growing again has been the primary task of FHA throughout this economic crisis. This task did not come without its stresses and pressures. Due largely to legacy loans in both the forward and HECM portfolios, the short term health of the Fund and the ability of FHA to meet the requirement of the 2 percent capital reserve ratio have been impacted.

As noted previously, to comply with FCRA, on September 30, 2013, FHA was required to take a mandatory appropriation of $1.68 billion in order to have sufficient funds on hand for the payment of expected losses on its portfolio of guaranteed loans through September 2012. The need to take this mandatory appropriation – a function of the annual budget re-estimate performed during the formulation of the President's FY 2013 Budget – does not incorporate improvements or other changes in performance of the Fund, or improvements in the broader economy, since the calculation was completed in December 2012. As a result of this $1.68 billion transfer of funds, on October 1, 2013, the Fund had a capital account balance of over $48 billion.

The amount of the mandatory appropriation is higher than the estimate provided in the President's budget because of the decline in FHA endorsement volume over the last few months of the fiscal year – consistent with the trend in the broader housing market in response to higher interest rates. It is also consistent with FHA's goal of reducing its footprint in the market.

As stated earlier, this required mandatory appropriation does not reflect an up-to-date view of the MMIF's performance, its long-term fiscal health, or its current cash position. The required mandatory appropriation does not mean that FHA is in need of cash to pay claims. For more than 80 years, FHA has been a vital resource for first time, minority and low wealth borrowers while earning revenues that are returned to the Treasury and American taxpayers. FHA currently has more than $48 billion in liquid assets—cash and investments—on hand and generated an additional $17 billion in FY2013. These are more than sufficient resources to allow FHA to fund its claims activity. In fact, if our asset disposition recovery rates continue to improve as they have over the past year due to our efforts, recoveries over the next three years will be $5 billion higher than expected – exceeding the amount of the draw.

New estimates for FY14 will include these improvements and other changes in performance, as well as adjusted expectations for the future. We expect updated data and economic forecasts to reflect that the health of the fund has improved significantly since these calculations were completed nearly a year ago. However, as with all financial institutions, the ultimate health of a portfolio is partially a function the broader economic environment. The October 2013 government shutdown is estimated to have costs the economy $24 billion and resulted in 120,000 fewer jobs through October 12, 2013. These estimates have implications for the economy at large. Therefore, while FHA will continue to focus on protecting and improving the performance of the Fund – playing its critical role of ensuring access to credit for qualified borrowers in underserved markets – the outcome of future assessments of the Fund will be impacted by the underlying long-term economic assumptions.

Tools for a Stronger, More Secure FHA

Over the past several years, Congress has moved in important ways to strengthen and protect FHA, and for that we are very grateful. Indeed, were it not for the flexibility granted by Congress to FHA in 2010 in setting premium pricing, the current economic value of the MMIF would be more than $10 billion lower than it is today. However, it is clear that there is still much that to do that only a partnership between FHA and Congress can achieve. Since 2010, as FHA has worked to bolster the long term health of the MMIF, the agency has requested several tools from Congress to better manage the Fund – and many of these requests, necessary to better protect the Fund, remain outstanding.

The proposals outlined below will enhance FHA's ability to hold lenders accountable for non-compliance with FHA policy and provide greater flexibility for FHA to make changes to policies and procedures as emerging needs and trends are identified. As a result, FHA will better be able to avoid unnecessary losses before they occur.

1. **Indemnification Authority for Direct Endorsement Lenders:** This provision, which FHA has been seeking since 2010, would allow FHA to seek indemnification from Direct Endorsement lenders, which represent 70% of all FHA approved lenders. Currently FHA only has authority to require indemnification for lenders with Lender Insurance (LI) approval. If granted this authority, FHA will be able to obtain indemnification from all of its approved lenders for loans that do not comply with its guidelines.

2. **Authority to Terminate Origination and Underwriting Approval:** This legislation would give FHA enhanced ability to review lender performance, and if a lender is found to have an excessive rate of early defaults or claims, would provide greater flexibility in terminating the approval of the lender to originate or underwrite single family mortgages for FHA insurance. FHA has been seeking this authority since 2010.

3. **Revised Compare Ratio Requirement:** This provision would revise the statute governing the Credit Watch Termination Initiative to provide greater flexibility in establishing the metric by which FHA compares lender performance so that it more effectively captures the true performance of a lender during all market conditions, minimizing further poor performance by FHA lenders while reducing uncertainty for them. Specifically, this legislation would allow the Secretary to compare the rate of early defaults and claims for insured single family mortgage loans originated or underwritten by a lender with those same rates for other lenders on any basis the Secretary determines appropriate, such as geographic area, varying underwriting standards, or populations served. Further, the provision would permit the Secretary to implement such comparisons via regulations, notice, or Mortgagee Letter. This will allow FHA to tailor the compare ratio such that it provides meaningful comparisons of lenders in varying market conditions, providing greater clarity for lenders and a more refined understanding of their performance for FHA.

4. **Authority to Direct Servicing:** In order to facilitate more effective loss mitigation, this change would give FHA the authority to require poorly performing servicers to engage a specialized subservicer with better performance results. Such authority would permit FHA to better avoid losses arising from poor servicing of FHA-insured loans, yielding better results for both borrowers and FHA.

5. **Reducing Barriers to Timely Risk Management:** Despite many policy and organizational changes made by FHA since 2009, the ability to manage risk appropriately

is still limited and continues to impact the FHA's long term fiscal health. These constraints include an increasingly complex mortgage market, aging FHA systems and infrastructure, a need for additional skills and expertise, and difficulty responding quickly to major risk issues as a result of contractual and statutory limitations. For FHA to manage risk and maintain operations as 21st century mortgage insurer, these constraints must be dealt with appropriately. For that reason, we would like to continue to explore tools which can be leveraged to allow FHA to minimize risk to the Fund and taxpayers while continuing to serve consumers with Congress and this Committee.

Conclusion

There are real signs of recovery in the nation's housing market. Given the progress we've seen—and FHA's central role in that progress—it's clear that FHA has done precisely what it was designed to do. It has allowed millions of American families to benefit from homeownership and affordable rental options. It has provided vital liquidity in the nation's mortgage finance markets. And it has acted as a vital stabilizing force when an economic crisis precipitated by the housing market could have led to a second Great Depression. While we recognize that the need for a mandatory appropriation is not welcome news to anyone, the fact is that it does not reflect the real time improvements to the portfolio due to the actions taken by this administration. FHA has been, and continues to be, a reliable steward of taxpayer dollars and a key source of access to homeownership, both for today's families as well as future generations. And, simply put, the account transfer completed on September 30, 2013, while not necessary for cash flow or claims, is a function of FHA's 79 year statutory mandate to stabilize the economy and preserve access to mortgage credit for creditworthy, underserved borrowers. And, because of the strength of the FHA and its staff through this crisis, the refinements to the FHA model made since 2009 will allow FHA to emerge from this the worst recession since the great depression as a stronger and more resilient organization, continuing to serve the housing market and stabilize the nation's economy.

Center for American Progress

The Federal Housing Administration Saved the Housing Market

John Griffith October 2012

Introduction

For close to 80 years the Federal Housing Administration has helped millions of working-class families achieve homeownership and has promoted stability in the U.S. housing market—all at no cost to taxpayers. The government-run mortgage insurer is a critical part of our economy, helping first-time homebuyers and other low-wealth borrowers access the long-term, low down-payment loans they need to afford a home.

More recently, the agency prevented a complete collapse in the housing market, likely saving us from a double-dip recession. As private investors retreated from the mortgage business in the wake of the worst housing crisis since the Great Depression, the Federal Housing Administration increased its insurance activity to keep money flowing into the market. Without the agency's support, it would have been much more difficult for middle-class families to get a home loan since the crisis began. Home prices would have plummeted even further, households would have lost much more wealth than they already did during the crisis, and even more families would have lost their homes to foreclosure.

A further decline in the housing market would have sent devastating ripples throughout our economy. By one estimate, the agency's actions prevented home prices from dropping an additional 25 percent, which in turn saved 3 million jobs and half a trillion dollars in economic output.[1]

But the agency was not immune to the housing crisis. Today it faces mounting losses on loans that originated as the market was in a freefall. Housing markets across the United States appear to be on the mend, but if that recovery slows, the agency may soon require support from taxpayers for the first time in its history.

If that were to happen, any financial support would be a good investment for taxpayers. Over the past four years, the Federal Housing Administration's efforts saved families billions of dollars in home equity (a 25-percent drop in home prices translates to about $3 trillion in lost property values today),[2] kept interest rates from skyrocketing (and with them monthly mortgage payments), and helped millions of workers keep their jobs.[3] Any support would amount to a tiny fraction of the agency's contribution to our economy in recent years. (We'll discuss the details of that support later in this brief.)

In addition, any future taxpayer assistance to the agency would almost certainly be temporary. The reason: Mortgages insured by the Federal Housing Administration in more recent years are likely to be some of its most profitable ever, generating surpluses as these loans mature. This is due in part to new protections and tightened underwriting standards put in place by the Obama administration.

The chance of government support has always been part of the deal between taxpayers and the Federal Housing Administration, even though that support has never been needed. Since its creation in the 1930s, the agency has been backed by the full faith and credit of the U.S. government, meaning it has full authority to tap into a standing line of credit with the U.S. Treasury in times of extreme economic duress—and no act of Congress is necessary.[4] Extending that credit isn't a bailout—it's fulfilling a legal promise.

Looking back on the past half-decade, it's actually quite remarkable that the Federal Housing Administration has made it this far without our help. Five years into a crisis that brought the entire mortgage industry to its knees and led to unprecedented bailouts of the country's largest financial institutions, the agency's doors are still open for business. This issue brief puts the agency's current financial troubles in perspective. It explains the role that the Federal Housing Administration has had in our nascent housing recovery, provides a picture of where our economy would be today without it, and lays out the risks in the agency's $1.1 trillion insurance portfolio.

What does the Federal Housing Administration do?

The Federal Housing Administration is a government-run mortgage insurer. It doesn't actually lend money to homebuyers but instead insures the loans made by private lenders, as long as the loan meets strict size and underwriting standards. In exchange for this protection, the agency charges up-front and annual fees, the cost of which is passed on to borrowers.

During normal economic times, the agency typically focuses on borrowers that require low down-payment loans—namely first time homebuyers and low- and middle-income families. During market downturns (when private investors retract, and it's hard to secure a mortgage), lenders tend rely on Federal Housing Administration insurance to keep mortgage credit flowing, meaning the agency's business tends to increase. Through this so-called countercyclical support, the agency is critical to promoting stability in the U.S. housing market.

The Federal Housing Administration is expected to run at no cost to government, using insurance fees as its sole source of revenue. In the event of a severe market downturn, however, the FHA has access to an unlimited line of credit with the U.S. Treasury. To date, it has never had to draw on those funds.

Without the Federal Housing Administration, the housing downturn would have been much worse

Since Congress created the Federal Housing Administration in the 1930s through the late 1990s, a government guarantee for long-term, low-risk loans—such as the 30-year fixed-rate mortgage—helped ensure that mortgage credit was continuously available for just about any creditworthy borrower. In the decades leading up to the recent crisis, the agency served a small but meaningful segment of the U.S. housing market, focusing mostly on low-wealth households and other borrowers who were not well-served by the private market.

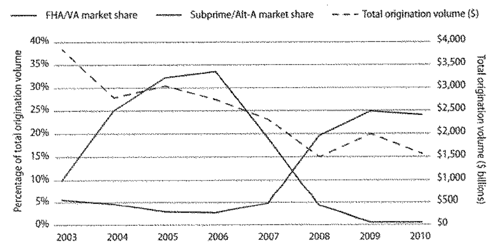
In the late 1990s and early 2000s, the mortgage market changed dramatically. New subprime mortgage products backed by Wall Street capital emerged, many of which competed with the standard mortgages insured by the Federal Housing Administration.[5] These products were often poorly underwritten (if underwritten at all) and were easier to process than FHA-backed loans, often translating into far better compensation for their originators. This gave lenders the motivation to steer borrowers toward higher-risk and higher-cost subprime products, even when they qualified for safer FHA loans.

As private subprime lending took over the market for low down-payment borrowers in the mid-2000s, the agency saw its market share plummet. In 2001 the Federal Housing Administration insured 14 percent of home-purchase loans; by 2005 that number had decreased to less than 3 percent.[6]

FIGURE 1

As private investors left the mortgage market, FHA insurance filled the gap

Share of annual origination volume (home purchases and refinancings), 2003–2010



Source: Center for Responsible Lending (citing data from Inside Mortgage Finance) and the Mortgage Bankers Association

The rest of the story is well-known. The influx of new and largely unregulated subprime loans contributed to a massive bubble in the U.S. housing market. In 2008 the bubble burst in a flood of foreclosures, leading to a near collapse of the housing market. Wall Street firms stopped providing capital to risky mortgages, banks and thrifts pulled back, and subprime lending essentially came to a halt. The mortgage giants Fannie Mae and Freddie Mac, facing massive losses on their own risky mortgage investments, were placed under government conservatorship and significantly scaled back lending, especially for home-purchase loans with low down payments.

The Federal Housing Administration's lending activity then surged to fill the gap left by the faltering private mortgage market. By 2009 the agency had taken on its biggest book of business ever,[7] backing roughly one-third of all home-purchase loans.[8] Since then the agency has insured a historically large percentage of the mortgage market, and in 2011 backed roughly 40 percent of all home-purchase loans in the United States.[9]

By playing this key countercyclical role, the Federal Housing Administration ensured that middle-class families could still buy homes, preventing a more devastating market downturn caused by a halt in home sales. The agency has backed more than 4 million home-purchase loans since 2008 and helped another 2.6 million families lower their monthly payments by refinancing.[10] Without the agency's insurance, millions of homeowners might not have been able to access mortgage credit since the housing crisis began, which would have sent devastating ripples throughout the economy.

It's difficult to quantify the agency's exact contribution to our economy in recent years. But when Moody's Analytics studied the topic in the fall of 2010, the results were staggering. According to preliminary estimates, if the Federal Housing Administration had simply stopped doing business in October 2010, by the end of 2011 mortgage interest rates would have more than doubled; new housing construction would have plunged by more than 60 percent; new and existing home sales would have dropped by more than a third; and home prices would have fallen another 25 percent below the already-low numbers seen at this point in the crisis.[11]

A second collapse in the housing market would have sent the U.S. economy into a double-dip recession. Had the Federal Housing Administration closed its doors in October 2010, by the end of 2011, gross domestic product would have declined by nearly 2 percent; the economy would have shed another 3 million jobs; and the unemployment rate would have increased to almost 12 percent, according to the Moody's analysis.[12]

TABLE 1

Without the Federal Housing Administration, the housing market would have collapsed in 2011, sending the U.S. economy into a double-dip recession

Projected year-to-year changes in key economic indicators had the agency stopped insuring mortgages in October 2010

Indicator	Percent change
U.S. housing market	
Fixed Mortgage Rate	+6.7 percentage points
Residential Housing Starts	-63.0%
New and Existing Home Sales	-40.5%
Median Existing-House Price	-25.0%

Indicator	Percent change
Broader economy	
Total Employment	-2.7%
Unemployment Rate	+1.6 percentage points
Gross Domestic Product	-3.7%
S&P 500	-39.2%

Source: Draft estimates from Moody's Analytics, October 2010

"[The Obama administration] empowered the Federal Housing Administration to ensure that households could find mortgages at low interest rates even during the worst phase of the financial panic," wrote Mark Zandi, chief economist at Moody's Analytics, in *The Washington Post* last month. "Without such credit, the housing market would have completely shut down, taking the economy with it."[13]

The Federal Housing Administration was available when other insurers were not but became vulnerable to losses in the process

Despite a long history of insuring safe and sustainable mortgage products, the Federal Housing Administration was still hit hard by the foreclosure crisis. The agency never insured subprime loans, but the majority of its loans did have low down payments, leaving borrowers vulnerable to severe drops in home prices.

The agency is currently facing massive losses on loans insured in the later years of the housing bubble and the early years of the financial crisis, when lenders starting turning to the agency to sustain their origination volume and certain homebuyers found few alternatives to FHA-insured loans (mainly those who didn't have pristine credit and cash for a 20-percent down payment).[14] These losses are the result of a higher-than-expected number of insurance claims, resulting from unprecedented levels of foreclosure during the crisis.

According to recent estimates from the Office of Management and Budget, loans originated between 2005 and 2009 are expected to result in an astounding $27 billion in losses for the Federal Housing Administration. The 2008 book of business alone accounts for about $11 billion of those losses, making it the worst book in the agency's history by just about any metric (the agency eventually strengthened its business by issuing new underwriting standards and other protections that took effect second fiscal quarter of 2009—which we'll discuss later in this issue brief.)[15]

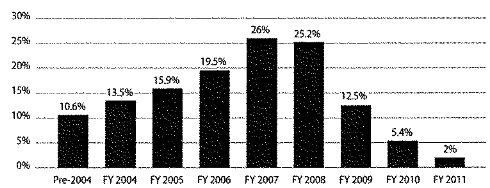
These books of business have a high concentration of so-called seller-financed down payment assistance loans, in which sellers covered the required down payment at the time of purchase often in exchange for inflated purchase-prices.[16] Seller-financed loans were often riddled with fraud and tend to default at a much higher rate than traditional FHA-insured loans. They made up about 19 percent of the total origination volume between 2001 and 2008 but account for 41 percent of the agency's accrued losses on those books of business, according to the agency's latest actuarial report.[17]

For years the Federal Housing Administration tried to eliminate seller-financed down payment assistance from its programs but met strong opposition in Congress, thanks in part to a "well-coordinated lobbying effort by a coalition of the nonprofit companies, housing and minority groups and home builders," according to *The Wall Street Journal*.[18] Congress finally banned seller-financed loans from the agency's insurance programs in the Housing and Economic Recovery Act of 2008 (which didn't actually take effect until the second fiscal quarter of 2009). If such a ban had been in place from the start, the agency could have avoided more than $14 billion in losses, which would have put it in a much better capital position going into the crisis, according to the latest actuarial report.[19]

FIGURE 2

A high percentage of FHA-insured loans originated in 2006, 2007, and 2008 are expected to go to claim in the near future

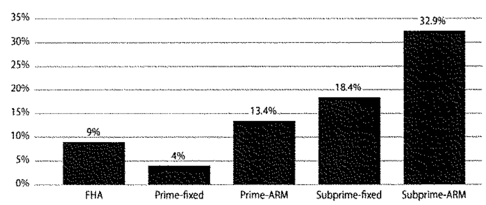
Percentage of FHA-backed mortgages that have missed at least three consecutive payments or are in bankruptcy/foreclosure processing



Source: Federal Housing Administration's Delinquency and Claim Rate Activity and Trends Report, July 2012

But as a whole, FHA's delinquency rates are much lower than riskier mortgage products

Percentage of mortgages that have missed at least three consecutive payments or are in bankruptcy/foreclosure processing by type of loan



Source: Mortgage Bankers Association National Delinquency Survey, First Quarter of 2012

While millions of FHA-backed loans have already ended in an insurance claim that had to be paid by the agency, millions more are still in the foreclosure pipeline. For instance, roughly one in four outstanding FHA-backed loans made in 2007 or 2008 is "seriously delinquent," meaning the borrower has missed at least three payments or is in bankruptcy or foreclosure proceedings.[20]

A disproportionate percentage of the agency's serious delinquencies are seller-financed loans that originated before January 2009 (when such loans got banned from the agency's insurance programs). According to agency estimates, roughly

725,000 FHA-backed loans are seriously delinquent today, and about 14 percent of those loans had seller-financed down-payment assistance. By comparison, seller-financed loans make up just 5 percent of the agency's total insurance in force today.[21]

As riskier loans pass through the system, the agency's more recent books of business are very strong

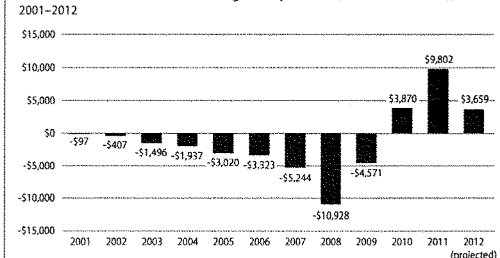
While the losses from loans originated between 2005 and early 2009 will likely continue to appear on the agency's books for several years, the Federal Housing Administration's more recent books of business are expected to be very profitable, due in part to new risk protections put in place by the Obama administration. Beginning in 2009 the agency increased insurance premiums four times—to the highest levels in its history. It also enforced new rules that require borrowers with low credit scores to put down higher down payments, took steps to control the source of down payments, overhauled the process through which it reviews loan applications, and ramped up efforts to minimize losses on delinquent loans.[22]

As a result of these and other changes enacted since 2009, the 2010 and 2011 books of business are together expected to bolster the agency's reserves by nearly $14 billion, according to recent estimates from the Office of Management and Budget. The new 2012 book of business is projected to add another $3.7 billion to their reserves, further balancing out losses on previous books of business.[23]

FIGURE 3

FHA's books of business have gotten much stronger since the housing crisis began

Total economic value of each book of single-family business (in millions of dollars), 2001–2012



Source: Office of Management and Budget, Federal Credit Supplement in the FY 2013 budget

These are, of course, just projections, but the tightened underwriting standards and increased oversight procedures are already showing signs of improvement. At the end of 2007 about 1 in 40 FHA-insured loans experienced an "early period delinquency," meaning the borrower missed three consecutive payments within the first six months of origination—usually an indication that lenders had made a bad loan. That number is closer to 1 in 250 today.[24]

The agency's capital reserves are still uncomfortably low today

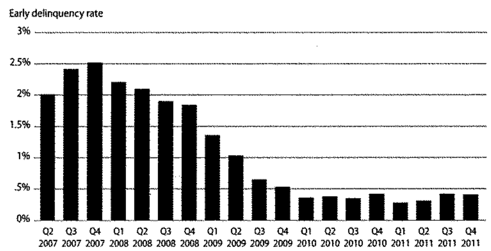
Despite these improvements, the capital reserves in the Mutual Mortgage Insurance Fund—the fund that covers just about all the agency's single-family insurance business—are uncomfortably low. Each year independent actuaries estimate the fund's economic value: If the Federal Housing Administration simply stopped insuring loans and paid off all its expected insurance claims over the next 30 years, how much cash would it have left in its coffers? Those excess funds, divided by the total amount of outstanding insurance, is known as the "capital ratio."

The Federal Housing Administration is required by law to maintain a capital ratio of 2 percent, meaning it has to keep an extra $2 on reserve for every $100 of insurance liability, in addition to whatever funds are necessary to cover expected claims. As of the end of 2011, the fund's capital ratio was just 0.24 percent, about one-eighth of the target level.[25]

FIGURE 4

FHA's tightened underwriting and increased oversight on lenders have caused early delinquencies to drop significantly since the crisis began

Quarterly percentage of loans that have a 90-day default within 6 months of origniation, 2007–2011



Source: Federal Housing Administration, Quarterly Report to Congress for Q3 2012

The agency has since recovered more than $900 million as part of a settlement with the nation's biggest mortgage servicers over fraudulent foreclosure activities that cost the agency money.[26] While that has helped to improve the fund's financial position, many observers speculate that the capital ratio will fall even further below the legal requirement when the agency reports its finances in November.

This is a legitimate concern but not one that should be overstated. As required by law, the Mutual Mortgage Insurance Fund still holds $21.9 billion in its so-called financing account to cover all of its expected insurance claims over the next 30 years using the most recent projections of losses. The fund's capital account has an additional $9.8 billion to cover any unexpected losses.[27]

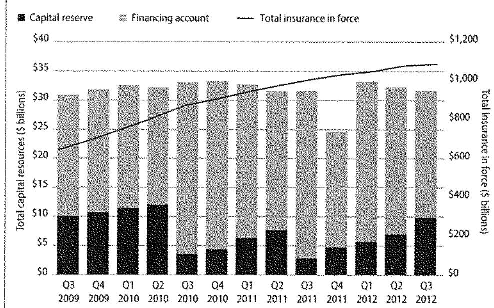
That's not enough to meet the 2 percent capital ratio target, but the agency still has plenty of cash on hand to cover its insurance liabilities based on reasonable expectations in the housing market—and even has some extra money set aside for a rainy day.

That said, the agency's current capital reserves do not leave much room for uncertainty, especially given the difficulty of predicting the near-term outlook for housing and the economy. In recent months, housing markets across the United States have shown early signs of a recovery. If that trend continues—and we hope it does—there's a good chance the agency's financial troubles will take care of themselves in the long run.[28]

FIGURE 5

Though the capital buffer is depleting, FHA still has plenty of money in its financing account to keep business going

FHA's overall capital position and total insurance in force, Q3 2009–Q3 2012 (in billions)



Source: Federal Housing Administration, Quarterly Report to Congress for Q3 2012

But if the recovery stalls and home prices begin to dip lower—which likely would cause another wave of foreclosures—the Federal Housing Administration's capital cushion may not be sufficient. In that unfortunate event, the agency may need some temporary support from the U.S. Treasury as it works through the remaining bad debt in its portfolio. This support would kick in automatically—it's always been part of Congress' agreement with the agency, dating back to the 1930s—and would amount to a tiny fraction of the agency's portfolio.[29] It would also be a bargain, considering how taxpayers have benefitted from the agency over the past eight decades—and especially the past four years.

How would taxpayer "support" to the Federal Housing Administration work?

Once a year the Federal Housing Administration moves money from its capital account to its financing account, based on re-estimated expectations of insurance claims and losses. (Think of it as moving money from your savings account to your checking account to pay your bills.) If there's not enough in the capital account to fully fund the financing account, money is drawn from an account in the U.S. Treasury to fill the gap.

Such a transfer does not require any action by Congress. Like all federal loan and loan guarantee programs, the Federal Housing Administration's insurance programs are governed by the Federal Credit Reform Act of 1990, which permits them to draw on Treasury funds if and when they are needed.[30]

The Federal Housing Administration's current financial troubles must be kept in perspective

It's rather astonishing that the Federal Housing Administration made it this far without requiring taxpayer support, especially in light of the financial troubles the agency's counterparts in the private sector experienced. In the wake of the crisis, most private mortgage insurers have either gone out of business[31] or significantly scaled back their insurance activity,[32] while the agency meaningfully increased its insurance activity to help keep the market afloat and prevent another crisis.

If the agency does require support from the U.S. Treasury in the coming months, taxpayers will still walk away on top. The Federal Housing Administration's actions over the past few years have saved taxpayers billions of dollars by preventing massive home-price declines, another wave of foreclosures, and millions of terminated jobs. Considering the strength of the agency's recent books of business, any temporary assistance would almost certainly be paid back over a reasonable time frame.

To be sure, there are still significant risks at play. There's always a chance that our nascent housing recovery could change course, leaving the agency exposed to even bigger losses down the road. That's one reason why policymakers must do all they can today to promote a broad housing recovery, including supporting the Federal Housing Administration's ongoing efforts to keep the market afloat.

Regardless of how the mortgage market changes in the coming years, the agency continues to serve a vital purpose, both by expanding homeownership to underserved segments of the market and by providing liquidity in times of economic duress. The agency has filled both roles dutifully in recent years, helping us avoid a much deeper economic downturn. For that, we all owe the Federal Housing Administration a debt of gratitude and our full financial support.

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Endnotes

1 Unpublished estimates from Moody's Analytics, October 2010. Data provided to the author from Moody's Analytics.

2 According to CoreLogic, total property values in the U.S. totaled about $12.4 trillion at of September 2012. For more, see http://www.corelogic.com/about-us/news/asset_upload_file516_16435.pdf.

3 Unpublished estimates from Moody's Analytics, October 2010. Data provided to the author from Moody's Analytics.

4 The 1934 National Housing Act, which created the Federal Housing Administration, states: "In the event that the amount in the [Mutual Mortgage Insurance] Fund is insufficient to pay upon demand, when due, the principal of or interest on any debentures so guaranteed, the Secretary of the Treasury shall pay to the holders the amount thereof which is hereby authorized to be appropriated out of any money in the Treasury not otherwise appropriated, and thereupon to the extent of the amount so paid the Secretary of the Treasury shall succeed to all the rights of the holders of such debentures." See P.L. 479, Sec. 204 (b).

5 John A. Karikari, Ioan Voicu, and Irene Fang, "FHA vs. Subprime Mortgage Originations: Is FHA the Answer to Subprime Lending?" Journal of Real Estate Finance and Economics 43 (4) (2011): 441-458 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1824923.

6 Department of Housing and Urban Development, FHA-Insured Single Family Mortgage Originations and Market Share Report 2011- Q3, (2011), available at http://portal.hud.gov/hudportal/documents/huddoc?id=fhamktq3_11.pdf.

7 Department of Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2011, (2011), available at http://portal.hud.gov/hudportal/documents/huddoc?id=FHAMMIFundAnnRptFY11No2.pdf.

8 Department of Housing and Urban Development, FHA-Insured Market Share Report 2011, (2011), available at http://portal.hud.gov/hudportal/documents/huddoc?id=fhamktq3_11.pdf.

9 Department of Housing and Urban Development, "FHA Issues Annual Financial Status Report to Congress," Press release, November 15, 2011, available at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2011/HUDNo.11-270.

10 Department of Housing and Urban Development, FHA Single-Family Mutual Mortgage Insurance Fund Programs, Q3 2012, (2012), available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.

11 Unpublished estimates from October 2010. Data provided to the author from Moody's Analytics.

12 Ibid.

13 Mark Zandi, "Obama policies ended housing free fall," The Washington Post, September 28, 2012, available at http://www.washingtonpost.com/realestate/obama-policies-ended-housing-free-fall/2012/09/27/20635604-0372-11e2-9b24-ff730c7f6312_story.html.

14 Some analysts, such as Robert Van Order and Anthony Yezer from George Washington University, argue that FHA's rigid and inflexible structure might have actually helped the agency stem losses during the crisis. For example, as the subprime bubble grew, Fannie Mae and Freddie Mac eventually changed its underwriting and other rules to compete with the subprime market. FHA was "hard-wired" by legislation, meaning it continued to lose market share at "just the right time," according to Van Order and Yezer. For more information, see "FHA Assessment Report: The Role of the Federal Housing Administration in a Recovering U.S. Housing Market" at http://business.gwu.edu/files/fha-assessment-report-02-2011.pdf.

15 For example, when Congress banned seller-financed down payment assistance in 2008, the law stated that FHA could not insure any seller-financed loans that closed after September 2008. But it takes some time for those loans to be processed for FHA insurance, so FHA insured approximately 40,000 seller-financed loans in October and November - the first months of fiscal year 2013. Losses on these loans count toward the FY 2013 book of business.

16 According to a 2005 study from the Government Accountability Office, FHA-insured homes bought with seller-funded nonprofit assistance were appraised at and sold for about 2 to 3 percent more than comparable homes bought without such assistance. For more information, see "GAO-06-24: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance," available at http://www.gao.gov/new.items/d0624.pdf.

17 Integrated Financial Engineering, Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans For Fiscal Year 2011. (Department of Housing and Urban Development, 2011), available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/actr/actrmenu

18 Nick Timiraos, "U.S.-Backed Mortgage Program Fuels Risks: FHA Struggles to Eliminate Loans for Zero Down," The Wall Street Journal, June 24, 2008, available at http://online.wsj.com/article/SB121426681678998589.html.

19 Ibid.

20 Department of Housing and Urban Development, FHA Single-Family Mutual Mortgage Insurance Fund Quarterly Report to Congress FY 2012 Q2, (2012), available at http://portal.hud.gov/hudportal/documents/huddoc?id=MMIQtrlyQ2_2012Final.pdf.

21 Author's analysis of data reported in FHA's Single Family Insurance Delinquency and Claim Rate Activity and Trends Report, July 2012.

22 To further contain losses, FHA in June announced plans to expand an initiative for the bulk sale of seriously delinquent loans to investors that specialize in working with struggling homeowners. Since a seriously delinquent loan is very likely to end up in an insurance claim, these sales will fetch less than the total amount owed on the loan but more than the agency would expect to recoup through the foreclosure process, meaning the agency saves money. In exchange, the buyer agrees to delay foreclosure for at least six months and negotiates a new deal with the delinquent borrower, increasing the family's chance of staying in their home. For more, see John Griffith, "The FHA is on Board With Principal Reduction" (Washington: Center for American Progress, 2012), available at http://www.americanprogress.org/issues/housing/news/2012/06/11/11699/the-fha-is-on-board-with-principal-reduction/.

23 Integrated Financial Engineering, Actuarial Review.

24 Department of Housing and Urban Development, FHA Single-Family Quarterly Report to Congress.

25 Department of Housing and Urban Development, Annual Report to Congress.

26 Secretary Shaun Donovan, Testimony before the Subcommittee on Banking, Housing, and Urban Affairs, "FY 2013 Budget Request for the Department of Housing and Urban Development," April 26, 2012, available at http://portal.hud.gov/hudportal/HUD?src=/press/testimonies/2012/2012-04-26.

27 Ibid.

28 In last year's actuarial report, FHA predicted that the capital reserve would return to the 2-percent threshold 2014, assuming slight rebound in home prices starting in 2012 (along with changes in interest rates and other economic conditions). The underlying model for that projection, prepared by Moody's analytics, assumed a 5.6-percent drop in home prices for 2011 and a 1.2-percent increase in 2012. In reality, home prices fell by just 2.5 percent in 2011 and increased 1.8 percent in the first half of 2012, according to the Federal Housing Finance Agency. For more, see Sarah Wartell and John Griffith, "Too Soon to Sound the FHA Alarm" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/housing/report/2011/12/12/10787/too-early-to-sound-the-fha-alarm/.

29 It's unclear how large such a loan would have to be. Before the $900 million settlement payment in February, the Obama administration's 2013 budget requested $688 million in Treasury draws to ensure FHA's solvency. To date, FHA still has not drawn any money from the U.S. Treasury.

30 For more on the Federal Credit Reform Act of 1990 and budget issues facing federal credit programs, see John Griffith and Richard Caperton, "Managing Taxpayer Risk: The Federal Government Responsibly Prices and Manages Risk When Issuing Loans and Loan Guarantees" (Washington: Center for American Progress, 2012), available at http://www.americanprogress.org/issues/economy/report/2012/05/03/11571/managing-taxpayer-risk/.

31 PMI Group, one of the country's largest private mortgage insurers, filed for Chapter 11 bankruptcy in November 2011 after posting 16 straight quarterly losses. Another major insurer, Triad Guaranty Inc., stopped selling policies in July 2008. See: Dawn McCarty and Steven Church, "PMI Group Seeks Bankruptcy After Regulators Take Over Main Unit," Bloomberg Businessweek, November 28, 2011, available at http://www.businessweek.com/news/2011-11-28/pmigroup-seeks-bankruptcy-after-regulators-take-over-mainunit.html.

32 According to the Federal Housing Finance Agency, private mortgage insurers underwrote $193.4 billion in insurance in 2008, the first year after the housing bust. That was the industry's lowest volume since 2000. See: Federal Housing Finance Agency, "State of the Private Mortgage Insurance Industry" (2009), available at http://www.fhfa.gov/webfiles/14779/MMNOTE_09-04%5B1%5D.pdf.

Financial Services Committee Hearing:
"Federal Housing Administration: Implications of a $1.7 Billion Taxpayer Bailout"

October 29, 2013

Questions for the Record from Representative Royce

During the hearing you suggested that you did not exactly know what Richmond, California's plan was for the use of eminent domain to seize performing mortgages from investors. I shared with you a slide which details the plan which Mortgage Resolution Partners has developed and to which Richmond, California has agreed. I have attached both the slide (page 17) and the larger proposal for your review. Given that this is no longer hypothetical, as I pointed out in the hearing, and it is clear that FHA is integral to the eminent domain scheme, can you please provide this Committee your view on this use of the FHA insurance fund? Is it appropriate public policy both for the health of the FHA and in the interests of bringing private capital back into the housing markets for the FHA to insure mortgages that are seized through eminent domain?

HUD is concerned about the recent developments in Richmond, California, but also recognizes that eminent domain is an inherent and often indispensable tool for local governments to accomplish important public purposes. On balance, a number of municipalities across the country have considered the issue and ultimately rejected it, including San Bernardino, California; Salinas, California; and Brockton, Massachusetts. Notions of using eminent domain to condemn and refinance mortgages would potentially raise a number of novel issues that State and local governments and the courts will have to carefully consider and resolve. Municipalities are deciding whether pursuing such a policy best serves their communities.

There are a number of steps that would need to be taken in exercising this tool to refinance underwater mortgages. Municipalities would have to develop and execute a condemnation and compensation plan that will survive legal scrutiny under both federal and state laws and legal precedent, as well as political scrutiny from their citizens and other stakeholders. It is important to note that no municipality has begun legal proceedings to condemn a mortgage, compensate the property holder, and then refinance the mortgage.

Until such plans produce concrete, analyzable results, HUD will not know about any possible impact they will have on FHA and the mortgage market. Any guidance from FHA on this issue would take into account these numerous factors and would be narrowly tailored to avoid any unintended consequences. For these reasons, we believe it is most sensible to consider what if any programmatic response from FHA is appropriate when more information about such possible use of eminent domain becomes available.

Financial Services Committee Hearing:
"Federal Housing Administration: Implications of a $1.7 Billion Taxpayer Bailout"

October 29, 2013

Questions for the Record from Congresswoman Sinema

1. *As you know, the National First Look program is a first-ever-public-private partnership agreement between HUD and the National Community Stabilization Trust. In Phoenix, Arizona, The First Look program gives Neighborhood Stabilization Program grantees a brief exclusive opportunity to purchase bank-owned properties in target neighborhoods so these homes can either be rehabilitated, rented, resold, or demolished. Can you provide an update on the impact the program has had in Phoenix? Has the program reduced residential vacancy rates as intended?*

Phoenix was awarded $115 million in Neighborhood Stabilization Program (NSP) grants. When the funds were awarded in 2009, Phoenix had a vacancy rate as high as 12 percent in its target areas. However, with the help of the National Community Stabilization Trust (NCST) the city addressed some 2,584 units with its NSP awards, surpassing its program goal (2,017) by almost 600 units. Of the 402 single-family units purchased, 61 percent or 249 homes were acquired through NCST. However, the City is not the only NSP grantee carrying out projects in Phoenix. NCST also worked with subrecipients to the Arizona Department of Housing and NSP2 grantee Chicanos Por La Causa. Between the three grantees—City of Phoenix, State of Arizona and Chicanos Por La Casa, NSP has impacted 3,587 units of which 494 were acquired through NCST. This does not include all properties that were viewed via the National First Look program only those that were actually acquired.

Using the Neighborhood Investment Cluster (NIC) Reports, we learn that the vacancy rates in many target areas have reduced and in some cases where the rates have increased, they continue to perform better than comparable neighborhoods. These clusters are scored on home price changes and vacancy rate changes. Because the House Financial Services Committee question focuses on vacancy rates, we pulled to sample of NICs, one in south Phoenix and one on the west side to illustrate the changes. The NIC score is grouped with three comparable neighborhoods. The focus is on the change in the rate of vacancy. So, if the 2008 vacancy rate in an area was five percent and it is now 10 percent, then the change in vacancy rate is 100 percent. A negative percentage change shows that the vacancy rate decreased. The impact of the National First Look can also be evaluated based on an increasing change that is less than the comparables, meaning while a NIC may have a rising vacancy rate, vacancies are not rising as fast as comparable areas.

As illustrated in the attached charts, there were two NICS that had a reduction in vacancy rates between 2008 and 2012. There was also one NIC that had lower vacancy rates than its three comparable areas and three NICs that beat at least one of its comparable areas.

Southside Phoenix Neighborhood Investment Clusters

Vacancy Change 2008-12

NIC	Subject	Comp. 1	Comp. 2	Comp. 3	Units by Grantee
10	5.58%	21.34%	21.34%	57.54%	Arizona State Program (1), Phoenix, AZ (21)
11	26.96%	-8.06%	-6.26%	-6.26%	Arizona State Program (2), Phoenix, AZ (8)
16	12.83%	4.10%	10.61%	17.61%	Arizona State Program (3), Chicanos Por La Causa, Inc. (1), Phoenix, AZ (2)
27	-9.54%	10.61%	33.25%	-65.95%	Arizona State Program (1), Chicanos Por La Causa, Inc. (5), Phoenix, AZ (7)

Westside Phoenix Neighborhood Investment Clusters

Vacancy Change 2008-12

NIC	Subject	Comp. 1	Comp. 2	Comp. 3	Units by Grantee
7	167.34%	12.51%	-22.11%	20.02%	Chicanos Por La Causa, Inc. (112)
11	-26.96%	-8.06%	-6.26%	-6.26%	Arizona State Program (2), Phoenix, AZ (8)
13	183.61%	123.34%	22.68%	2.52%	Phoenix, AZ (3)
15	34.79%	115.52%	53.93%	6.84%	Phoenix, AZ (11)
20	31.08%	6.16%	18.71%	389.60%	Phoenix, AZ (6)
36	246.84%	171.84%	93.72%	40.01%	Chicanos Por La Causa, Inc. (1), Glendale, AZ (1)

2. *FHA has recently adopted a number of policy changes, including changes related to the fees that it charges its mortgage requirements, in an attempt to limit risk to the MMIF. These policy changes have included increasing mortgage insurance premiums, instituting a minimum credit score requirement, and raising down payment requirements for borrowers with lower credit scores. Have these efforts been successful? What additional efforts are being undertaken to protect and improve the performance of the Fund?*

   Have these efforts been successful (limiting risk)?

FHA's efforts to limit risk to the MMIF have been impactful and continue to set the Fund on the right track. Recent books of business are some of the strongest in the history of the agency and are proving even more valuable than initial estimates. Early payment delinquencies – loans that have a 90-day delinquency within the first six months – have seen a steep decline and are down to less than a quarter of a percentage point of all FHA originations. Foreclosure starts are down more than 40 percent from their peak in 2012. Serious delinquencies have shown an improvement year over year, down to 8.15 percent in the most recently available data.

FHA made structural changes to the HECM program – limiting up-front draws and requiring financial assessments to ensure that seniors could use this tool responsibly and reducing future losses to the program. FHA also issued new guidance on streamlined short sales, allowing more families to avoid foreclosure while reducing FHA's losses.

Changes to loss mitigation procedures have also allowed servicers to offer deeper payment relief to FHA borrowers, minimize carrying costs to the fund, and increase the number of borrowers able to retain their homes. This has provided greater relief to borrowers by moving FHA HAMP up the waterfall, better effectuating lower monthly payments at a level that borrowers can afford.

FHA is undertaking a number of additional efforts to protect and improve the performance of the Fund:

- Homeowners Armed with Knowledge (HAWK) is our effort to embed housing counseling throughout the FHA origination and servicing process. The goal is to improve outcomes for families considering homeownership or who are already homeowners and improve the performance of the MMI fund. HAWK represents a major step forward for incorporating housing counseling into every step of the process of buying and owning a home.
- FHA is recovering more on defaulted loans by expanding the use of a variety of REO alternatives like the Distressed Asset Stabilization Program (DASP). DASP note sales improve recoveries to the fund while delaying foreclosure six months and getting loans in the hands of servicers who can take steps that allowed under FHA rules. 44 percent of our activity in FY13 was through REO alternatives. Combined with the Claims without Conveyance Program, which enables servicers to sell properties directly to third parties at a reserve price before they are conveyed to HUD, we are avoiding the costs of management and marketing of saleable REO. Both of these programs reduce costs and therefore increase recoveries to the Fund.
- Manual underwriting policy changes are expected to be published in the federal register in the first quarter of FY 2014. These policy changes include a new reserve requirement for all manually underwritten loans and caps based on borrower credit scores on the maximum qualifying ratios permitted.
- Interested Party Contribution policy changes are expected to be published in the Federal Register in the second quarter of FY 2014. These changes will reduce the maximum amount a seller or other interested party may contribute to a homebuyer's closing costs, and establish a schedule of the specific closing items to which these contributions may be applied.

These refinements, combined with all the sweeping changes we have made since the beginning of this administration, will allow us to continue to protect the long term health of the Fund.

Answer from FHA Commissioner Carol J. Galante to
Questions for the Record
"Federal Housing Administration: Implications of a $1.7 billion Taxpayer Bailout"

Financial Services Committee
United States House of Representatives
October 29, 2013

Congressman Keith Ellison

At the hearing, you were asked about local efforts being discussed in Richmond, California to use eminent domain to help the large number of underwater borrowers whose economic instability threatens the entire local economy. There are a handful of frustrated and desperate communities considering using eminent domain to address a deeply damaged housing market exacerbated by high unemployment, high vacancy rates, high levels of poverty and a high proportion of cost-burdened homeowners. I would oppose any proclamation or effort from the Federal Housing Administration and/or HUD threatening to withhold FHA insurance from communities that used eminent domain to assist underwater borrowers.

Commissioner Galante, please respond to these questions:

- **What types of assistance and how many dollars in assistance has the city of Richmond, California received from the Hardest Hit Fund? How about the cities of Fontana and Pomona, California, Yonkers, New York and Irvington, New Jersey?**

ANSWER: The Hardest Hit Fund is administered by the Department of Treasury. The most recent national data available for the performance of the Hardest Hit Fund is through 9/30/2013 and is made publicly available on Treasury's website. Treasury's website also posts links to state HFAs where they are required to report specific data on a quarterly basis.

http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/default.aspx

States have to report borrower characteristics, including by county of residence, but they don't have to report the amounts of assistance pledged or disbursed to specific cities or counties.

NJ: http://www.njhomekeeper.com/spv-55.aspx

CA: http://keepyourhomecalifornia.org/quarterly-reports/

It should be noted that New York is not receiving funding under HHF.

- **The U.S. Department of Housing and Urban Development and the Federal Housing Agency are prohibited from discriminating in the provision of credit. Can you explain how the Policy Statement on Discrimination in Lending (1994) (59 FR 18266-01), and 24 C.F.R. pt. 100 govern FHA's provision of mortgage insurance? Is credit discrimination prohibited against African Americans, Latinos and other ethnic minorities? Is discrimination prohibited on the basis of location?**

- **Have HUD and FHA ever ceased compliance with fair lending and fair housing laws? Has HUD and/or FHA ever denied credit to qualified borrowers who live in a particular location solely because of their location?**

ANSWER: As with mortgage lenders, FHA must comply with the Fair Housing Act, which prohibits housing discrimination because of race, color, sex, religion, national origin, disability, and familial status. The Fair Housing Act applies to all residential real estate-related transactions, including mortgages, mortgage insurance and other financial assistance that are related to residential real estate. FHA must also comply with the Equal Credit Opportunity Act, which prohibits credit discrimination because of race, color, religion, national origin, sex, marital status, age, or whether a person receives public assistance. Mortgage insurance must be made available without regard to the protected characteristic of the borrower.

The Joint Policy Statement on Discrimination in Lending, signed in 1994 by the federal agencies that are responsible for ensuring the administrative enforcement and regulation of the fair lending laws, describes the general principles that the participating agencies will consider to identify lending discrimination in violation of the Equal Credit Opportunity Act or the Fair Housing Act. The Policy Statement specifically states that it is intended to be consistent with those statutes and their implementing regulations and to provide guidance to lenders seeking to comply with them.

The regulations implementing the Fair Housing Act are published at 24 C.F.R. Part 100. The regulations, inter alia, detail types of discriminatory conduct under the Fair Housing Act. For example, the regulations provide illustrations of acts and practices by lenders and insurers that violate the Fair Housing Act. One such practice would be using different policies, practices, or procedures in determining the credit worthiness of a person applying for a loan or other financial assistance, because of the protected characteristic of the person.

Discrimination on the basis of location, per se, is not prohibited. However, lenders and insurers may not redline or refuse service to certain locations because of the race, national origin, or other protected characteristic of persons living in that location. Further, under some circumstances, actions that disproportionately affect persons based on a protected characteristic, regardless of intent to discriminate, may violate the Fair Housing Act.

· **It is my understanding that FHA supports principal reduction efforts, specifically through its Short Refinance Program. What is the Short Refinance Program? How has it worked? How much has the program saved taxpayers?**

ANSWER: The FHA Short Refinance Program offers "underwater" borrowers who do not currently have FHA insured loans the opportunity to refinance their loan into a new FHA-insured mortgage. In order to qualify, the borrowers need to be current on their mortgages or have successfully completed a trial payment plan under the program, and their lenders must agree to write off at least 10% of the unpaid principal balance (UPB) of the original mortgage. The new FHA loan cannot be more than 97.75% of the home's current value and the borrowers must satisfy all FHA criteria and underwriting guidelines.

This program has allowed HUD to provide stability to the housing markets in the wake of the worst financial crisis since the Great Depression. Because of the volatility of housing prices since 2008, these responsible homeowners saw their properties go underwater through no fault of their own, and this program provided a lifeline during this difficult time. This program has assisted almost 3,800 families since 2010, for a total loan volume of nearly $600 million.

The program has assisted investors, borrowers, lenders and communities by avoiding the cost and impacts of costly foreclosure proceedings. FHA Short Refinance has recently only completed its third year, and HUD does not yet have comprehensive performance data for the new FHA loans that were created as a result of this program. To date, only one loan in the entire program has resulted in a conveyance back to the lender.

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