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FEDERAL HOUSING ADMINISTRATION'S ROLE IN ADDRESSING THE HOUSING CRISIS

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

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FEDERAL HOUSING ADMINISTRATION'S ROLE IN ADDRESSING THE HOUSING CRISIS

THURSDAY, APRIL 10, 2008

U.S. SENATE,
SUBCOMMITTEE ON TRANSPORTATION AND HOUSING
AND URBAN DEVELOPMENT, AND RELATED AGENCIES,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 9:59 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Patty Murray (chairman) presiding.

Present: Senators Murray, Bond, and Allard.

OPENING STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. The subcommittee will come to order.

This morning we are discussing the Federal Housing Administration and its role in solving our Nation's housing crisis.

I am pleased to welcome back to the subcommittee our Federal Housing Commissioner, Brian Montgomery. A year ago when Commissioner Montgomery testified before us it was to talk about the fact that FHA was almost irrelevant to the housing market. At the time, the FHA's presence in the market had dropped to only 3 percent because so many lenders had taken advantage of the housing boom and instead offered exotic mortgage products without the FHA guarantee.

Well, a lot has changed in 1 year. The housing crisis has swept across our communities and some are now calling for the FHA to be the savior of the housing market. They are hoping that the Federal guarantee behind FHA loans could help jump-start the market again, and they hope it could allow unaffordable loans to be repackaged into affordable ones.

With all these proposals flying around, it is critical that this subcommittee take a fact-based, realistic look at what the FHA can actually do. We all want to lend a helping hand to struggling families who need it, but we need to focus on exactly who the FHA could help through updated laws and revised policies. And we need to recognize that some borrowers might be beyond reach. We do not want to invite a trend in which the worst mortgages are moved off the bankers' books and onto the Federal Government's.

My constituents have been clear that they do not want to wake up to learn that Congress has taken steps that leave the taxpayer holding the bag. And that is exactly what could happen if the FHA is pushed to buy loans that we know will go bad, if not this year, then next year, or the year after that.

So before we expand the role of the FHA, we absolutely must be sure that the proposals we are considering are not going to threaten its solvency, and we must ensure it has the tools and the flexibility to charge enough in fees to cover its costs because I cannot emphasize this enough. If the FHA cannot pay its debts, it will be this subcommittee's responsibility to appropriate the necessary funds to cover the shortfall. Every dollar we spend to cover defaults at the FHA is one less dollar we will have to spend on housing the homeless, providing section 8 vouchers to families who could not dream of owning a home, or rehabilitating public housing units to a safe and sanitary condition.

Now, at last year's hearing, we talked about many of the long-standing problems that burden the FHA, such as antiquated computer systems, short staffing, inadequate underwriting, and the inability to work seamlessly with lenders. The fact that we are now talking about pushing the FHA to salvage a distressed housing market does not mean that any of those problems we discussed last year have suddenly disappeared. We need to get real as we think about expanding FHA's responsibility to manage more troubled loans. Doing so will require more rigorous oversight and underwriting, not less.

So I believe that as we talk about expanding FHA's role, we must take several steps. We must talk about how we are going to strengthen the agency to protect the taxpayers who guarantee those loans, and since any proposal is expected to be voluntary for borrowers and lenders, we must get a realistic idea of how many people will actually participate. Third, we must be honest and recognize that the proposed solutions that make the best press release are not necessarily the ones that will best stabilize the market and keep families in their homes.

I am glad this morning to welcome Mr. David Kittle to the subcommittee. He is the incoming chairman of the Mortgage Bankers Association. He is not only a leader in his industry association; he is a lender who participates in FHA products today. I look forward to hearing his views on the kinds of programs he believes that will get the voluntary participation of both lenders and borrowers to help ease this problem.

And finally, I want to welcome Ken Wade, the CEO of NeighborWorks America. This subcommittee provided an historic increase in housing counseling funding as part of our 2008 Appropriations Act. It was, I think, the only legislation dealing with the housing crisis that became law last year.

Senator Bond and I provided this increase in funding through Mr. Wade's organization instead of through HUD so that we could get those dollars out quickly. Hundreds of thousands of homeowners are seeing the interest rates on their mortgages rise every quarter. So it was critical to put that money to use right away. And I want to thank Mr. Wade and all of his great, hard-working staff for getting a very large portion of that money out the door in record time.

Now, last night, working with Senator Bond, we were successful in boosting the additional funding for housing counseling up to $180 million during the Senate debate on our Foreclosure Prevention Act (H.R. 3221 EAS).

Mr. Wade works every day to help struggling borrowers keep their homes. So I look forward to hearing his thoughts about how FHA can be a strong partner. And I also look forward to his thoughts on our future housing counseling needs and challenges.

So thank you all for being here. I look forward to your testimony, and I will turn it over to my ranking member, Senator Bond for his comments.

OPENING STATEMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. Thank you very much, Madam Chair. I join you in welcoming our witnesses.

I am very pleased to support your comments about the need for fiscal responsibility in FHA because we have too many needs that we cannot meet now to put more burdens that might take away dollars which go to those people who cannot even think about owning homes.

As the chair has indicated, there are families in Washington, there are families in Missouri and across the Nation who are feeling the pain of the housing crisis, and they need our help now. When these people lose their homes, it has a devastating effect on the family.

But as I traveled around Missouri over the Easter recess, I found out just how disastrous these foreclosures are to the community, to the towns and cities in which they are located. The most vociferous advocates of stopping foreclosures were the mayors, the city councilmen, the neighborhood activists who realize what this can do to the whole community.

I am particularly interested today in hearing your views on how best we address the responsibility of the Federal Government in resolving the subprime crisis, as well as other market concerns. I think it is critical we take the right steps now to rebuild and strengthen the mortgage and housing market. The market is going to have to play itself out. There are some things that we can do and some things that reach too far. But clearly, this problem in the subprime and the housing and related industries has had a very, very deleterious effect on our economy and the world's economy.

I know many of these issues cannot be answered easily today, but I hope we can at least begin to address the stabilization of the subprime market. It is especially critical since I understand some 1.4 million subprime mortgages will face interest rate resets next year, and that from the resets, we can expect to see as many as 300,000 to 400,000 mortgage foreclosures. If we start to solve the subprime crisis now, we may be able to save many of these families from foreclosure, as well as beginning to turn around the larger economic issues facing the Nation.

Housing used to be one of the locomotives that pulled the U.S. economy. Right now it is pulling in the other direction, and we want to see that change.

Mr. Montgomery, your position in this is critical. Everybody tells us that you are the one who is going to solve it. So we are watching anxiously to see where you go. I am sorry there are votes that begin at 10:45 because I hope you have got a lot to tell us. I know you have announced some regulatory reforms that are designed to help resolve the subprime market without a bailout for either the homeowner or lender. I applaud you for those efforts and look forward to hearing the details of the reform, the timing, and the potential problems.

I am, however, very concerned about reports concerning the possible insolvency of FHA, and that needs to be cleared up, as the chair indicated. Obviously, we need to hear the views of Mr. Wade and Mr. Kittle on the proposed reforms. I also would like to know why it has taken FHA so long to propose these subprime reforms if legislation was not needed.

I also remain very concerned that the FHA is continuing to insure housing finance with seller down payments. I have fought this effort. It has been proposed by the administration, and it is actually occurring. But in general, where the seller-funded nonprofits provide down payment assistance to families in order to qualify for FHA mortgage insurance, they are putting the FHA and the families themselves at risk. Too often with these seller-funded down payments, families are put in homes they cannot afford, which has increased the risk of default, leading to the serious foreclosures we are seeing today. And that practice has serious consequences. Putting families in homes they cannot afford costs future homeowners by inflating real estate practices, by threatening the solvency of FHA, and not the least, ruining the credit status of those families foreclosed.

From 2000 to 2004, these loans, as a percentage of FHA's business, grew from 6 to 30 percent, with an approximate 35 percent default rate on seller-financed down payments with NEAMIA and other programs. Without some change in the law or elimination of the program, seller down payments of mortgages are expected to cost taxpayers as much as $1.4 billion in appropriations to pay for losses in fiscal year 2009.

As I understand it, the courts have not been receptive to HUD's attempts to ban this practice and have justified the most recent decisions on procedural grounds.

But putting families in homes they cannot afford costs communities. As we are seeing now, when one or two houses are foreclosed in a community, or in some instances, as many as 20 percent in some neighborhoods in Missouri, the entire community is afflicted by lower property values. The FHA witnessed this problem in the late 1980s caused by other poor FHA practices and decisions.

While I believe that Congress may have to take some legislative action to eliminate the seller down payment program in order to preserve FHA as a viable mortgage insurance program, I also assume you are rewriting your regulations to ban the program in a manner consistent with the courts' decisions.

I am also concerned that you have not taken other positive actions against this program. First, there appears to be fraud on the part of some sellers. Now, that is a good reason for termination or prosecution. The default rate alone for the program sounds like a reasonable justification for terminating participation under FHA. And I was under the impression that FHA can return defaulted mortgages to lenders under many circumstances. I hope that HUD, FHA are not sitting on their hands and are taking as aggressive steps as possible to terminate the losing program.

Also, I would like to hear about FHA's efforts to eliminate predatory lending. Back in the previous days when Senator Mikulski and I led the VA, HUD Appropriations Committee, we made the elimination of predatory lending a priority. However, I hear little out of HUD now about eliminating predatory lending throughout the mortgage industry. I think we all know that predatory lending contributed significantly to the subprime crisis, and I would like to know what HUD is going to do about it.

Mr. Wade, it is a pleasure to see you again. I thank you for joining me when we met on February 26, to announce the first $130 million in grant awards under the National Foreclosure Mitigation Counseling Program. I was proud to work with the chair and our Banking Committee Chair, Senator Dodd, to get these counseling funds approved by Congress in December.

As I said, over Easter I met with housing advocates, families, community leaders, officials across Missouri about the current crisis. I heard again and again about the importance of financial education like these counseling funds provide. Housing counselors I met with over the recess told me how these counseling funds are helping families know how to renegotiate with their banks or their lenders to get good refinancing and keep their homes.

They also emphasized the very important need for pre-mortgage counseling, and there is a program in HUD to do that. Has it not worked? Have we not funded it adequately? We need to know if we are getting adequate pre-mortgage counseling to make sure people do not get into these problems.

I know it is still early in this foreclosure mitigation program, but we will be anxiously awaiting the results of it. As I believe I told you, Mr. Wade, I am a Show Me Senator, and this sounds like a good idea. And we are looking to put more money into it, and they are talking about the need for much more. But I want to see the results. I want to know how many people you have been able to help. Is this working? Are there changes needing to be made? And we will expect to hear from you how well this program works.

Mr. Wade, I would also like to get your views on FHASecure. Everybody says it is a great idea to help threatened homeowners refinance their mortgage. They said they needed to see the eligibility for the program expanded so more people can be helped in staying in their homes.

Finally, Mr. Kittle, I look forward to your testimony as the only testimony from the private housing industry. I know mortgages are the lifeblood of your industry, and I expect the subprime market has impacted the ability of many of your members to make their normal livings, and the job problems cut across all mortgage and housing-related industries. I would like to hear about the overall impact on your industry and the related industries. And I would appreciate your views on the Government's role in the housing crisis and what you view as the key areas in which the Government can be helpful and not harmful.

With that, thank you, Madam Chair. We look forward to the witnesses' testimony.

Senator MURRAY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Madam Chairman, just out of respect for the subcommittee's time and the witnesses' time here, who I think we want to hear from, I am going to ask that my full statement be made a part of the record. I am just to make about a 10 or 15-second statement.

I just hope that if we decide to intervene in some way that we do not bail out irresponsible behavior both on the part of the lender, as well as the borrower. I hope that we do not end up saddling the taxpayer with a lot of obligation in this process.

Aside from that, I think that both you and Senator Bond are on the right track, and we will be anxious to hear from our witnesses.

[The statement follows:]

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Murray and Ranking Member Bond for holding this hearing to examine ways to help prevent foreclosures.

Homeownership has long been the American dream, and over the last decade record numbers of families were able to become homeowners. Unfortunately, too many homeowners, some knowingly, some unknowingly, bought homes they couldn't afford. Many of them took out exotic mortgages that made wildly unrealistic assumptions about the housing market, namely that housing values would continue to dramatically increase.

As we all now know, home price growth was unsustainable. Unfortunately, too many families are now facing the possibility of foreclosure. Just as ownership brings many benefits to families and neighborhoods, foreclosures have dramatic negative consequences for both individual homeowners and the economy as a whole.

We have seen a rapid increase in the number of foreclosures, and many experts predict that the number will continue to climb in the near future. Accordingly, Congress is currently considering various proposals to help prevent foreclosures.

This hearing will be an important step towards better understanding some of the suggestions to assist struggling homeowners. As part of any proposal, though, I think we must be careful not to reward irresponsible behavior. Borrowers have a responsibility to understand the terms of their loan, and lenders have a responsibility to provide them with clear, accurate information in order to help them understand the terms.

Borrowers have a responsibility to only borrow what they can repay, but lenders have a responsibility to only lend to those who can repay.

Should Congress choose to provide relief, it should not do so in a manner that is simply a "bail out" for either lenders or borrowers who acted irresponsibly. We should also not set a broad precedent that the Government will simply bail people out whenever they lose money or face tough times in the housing market.

I also believe that any efforts to address foreclosures should be done in a thoughtful, comprehensive manner. Any effort to provide foreclosure relief must carefully address any risk to taxpayers.

I would like to thank the witnesses for being here today. Your testimony will be helpful in understanding the many proposals currently pending to assist the families facing foreclosure.

Senator MURRAY. Thank you, Senator. I think the subcommittee shares your concern. Thank you.

With that, we will turn to our witnesses and begin with Mr. Montgomery. He is the Assistant Secretary for Housing and the Federal Housing Commissioner at HUD. We will then turn to Kenneth Wade, Chief Executive Officer of NeighborWorks America, and finally, David Kittle, who is the Chairman-Elect of the Mortgage Bankers Association.

Mr. Montgomery.

STATEMENT OF HON. BRIAN D. MONTGOMERY, ASSISTANT SECRETARY FOR HOUSING AND FEDERAL HOUSING COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. MONTGOMERY. Good morning, Chairwoman Murray. I would like to thank you, Ranking Member Bond, other Senators, for inviting me to testify.

As you know, the FHA has a valuable role in addressing the current challenges in the housing market, and there are many. In August of last year, the President introduced FHASecure to help more Americans facing foreclosure refinance into a safer, more affordable FHA loan. Since that time, almost 153,000 families have been able to refinance with FHA, and by year's end, we expect FHA will be able to help several hundred thousand families refinance into an affordable FHA-insured mortgage.

We have also made significant and positive impact on liquidity, something you hear a lot of late. Also, since September of last year, FHA has helped pump more than $68 billion of much-needed mortgage activity into the housing market. I want to say that almost $29 billion of that investment came through FHASecure.

Well, I think we could do more with FHASecure and we are. In fact, expanding the FHASecure program is the most appropriate and quickest means to help families in need. In fact, yesterday I announced the administration's plan to expand FHASecure. This expansion is appropriately tailored to homeowners who have demonstrated their commitment to making on-time payments perhaps though they have hit a financial rough spot. I want to emphasize that it is critically important to focus Government resources and programs on those homeowners who are working hard to fulfill their obligations.

In short, we will now back loans for borrowers who are financially capable but who have a spotty credit record. To qualify for a standard 97 percent LTV loan, borrowers will still be eligible if they were late on no more than 2 monthly mortgage payments, either consecutively or at two different times over the previous 12 months.

For borrowers who cannot meet the standard, FHA will permit up to 3 months of delinquencies, which again could be one consecutive 90-day late period or three 30-day late periods. But FHA will limit the LTV ratio for those borrowers to 90 percent.

Similar to existing practice, we will permit and encourage lenders to voluntarily write down outstanding principal and allow them to make any other arrangements, including new subordinate liens, to fill the gap between an existing loan balance and the new loan amount, be it a 97 percent or a 90 percent LTV loan.

These underwriting changes will also be coupled with a new and more flexible pricing policy at FHA. As you know, our program is funded through insurance premiums that homeowners pay. We are rolling out a new pricing plan that will base premiums on an individual's risk profile. This new administrative change will ensure the integrity of the FHA insurance fund. It will also protect the taxpayer and guarantee that FHA will be around to help struggling homeowners in the future.

With this expansion, we believe that by year's end, FHASecure will reach more than half a million homeowners. This figure represents a substantial portion of the total universe of homeowners. We have subprime ARM's who are owner occupants. They have documentation to demonstrate their ability to repay and are not already in foreclosure. We believe Government efforts should be focused on these struggling homeowners.

Because our underwriting standards remain strong, we will help more families keep their homes while managing an acceptable level of risk to the insurance fund. By charging a higher premium, we will also offset risk in many cases.

FHA modernization is another important step to strengthen the real estate market. The administration continues to urge Congress to reach agreement on a bill to modernize the FHA that the President can sign into law.

Quickly, there are two key components that must be part of any final FHA bill.

First, as previously mentioned, we must maintain our ability to offer a fair and equitable mortgage insurance premium structure. Any bill must give FHA the tools it needs to price for additional risk.

Second, legislation must include a provision, similar to one that passed in the Senate, to expressly prohibit down payment assistance from the seller or any other person or entity that stands to benefit from the transaction. Insured loans relying upon seller-funded down payment assistance have been demonstrated to have an unacceptably high risk of default and foreclosure. And data clearly demonstrate that FHA loans made to borrowers relying on this type of assistance go to foreclosure at close to three times the rate of loans made to borrowers who make their own down payments.

PREPARED STATEMENT

We simply cannot sustain seller-funded down payment business. We want FHA to be here not just for this generation, but for generations to come. And we must ensure the financial solvency of the fund is not compromised.

Thank you again for inviting me here to testify.

[The statement follows:]

PREPARED STATEMENT OF HON. BRIAN D. MONTGOMERY

Thank you, Chairwoman Murray. I would like to thank you and Ranking Member Bond for inviting me to testify.

As Commissioner of the Federal Housing Administration (FHA), you have asked me to comment on the role my agency is playing in the current housing crisis. I will explain this by discussing the following: our efforts to help homeowners under FHASecure, our recent administrative actions that extend FHA assistance to even more homeowners, the prompt need for FHA Modernization, and the proper way to provide downpayment assistance. By covering each of these topics, Madam Chairwoman, I believe you will see that FHA has taken action to help responsible homeowners stay in their homes.

FHASECURE

FHA has been able to use our administrative authority to help hundreds of thousands of Americans refinance their home loans. In August 2007, the President, Secretary Paulson, and Secretary Jackson introduced an effort, FHASecure, to help more Americans facing foreclosure refinance into a safer, more secure FHA loan. Since then, more than 150,000 families have been able to refinance with FHA. By year's end, we expect FHA will be able to help a total of about 500,000 families refinance into affordable FHA-insured mortgages.

It is important that the American people know about FHA opportunities. That is why FHA has mailed letters to hundreds of thousands of at-risk homeowners to urge them to refinance with safer, more affordable FHA-backed mortgages. These letters are being sent to homeowners who already have or soon will confront the first reset of their adjustable rate mortgage, and are currently living in locations subject to FHA loan limits. We will be sending these letters out to about 850,000 at-risk homeowners. Our response rate to the call centers has been so high that we need to add staff to accommodate the demand.

ADDITIONAL ACTIONS

We believe there is more that we can do with FHASecure. The reach of this program can and should be extended in a responsible way. Any expansion of FHASecure should continue its temporary nature and be focused on helping homeowners who are financially able and responsible, but who cannot refinance and stay in their homes without FHA assistance.

Expansion of FHASecure also would need to be achieved in a way that is consistent with the administration's principles on FHA Modernization. An expansion of FHASecure should include special underwriting flexibility to help more families qualify for FHA-insured mortgages. This includes making eligible more borrowers who were late on a couple of mortgage payments. These underwriting changes could also be made in exchange for lenders voluntarily writing down some of the outstanding mortgage principal if necessary to attain a prescribed loan-to-value ratio, and/or balanced with insurance premium adjustments when necessary to protect both the FHA insurance fund and the taxpayer.

FHA operates as a negative credit subsidy program, which means that it does not require Federal appropriations for its credit subsidy cost. Rather, the FHA program is funded through insurance premiums that homeowners pay themselves. In order to keep FHA operating without taxpayer subsidies, the expansions I outlined would be implemented with a new structure under which premiums would be set according to the relative risk borrowers pose. Basing mortgage insurance premiums on the individual risk of each loan, where risk is judged using traditional underwriting standards, is the best way to ensure that the taxpayer is protected and that FHA can help more families stay in their homes. It is how every responsible insurance company operates.

I believe these actions are consistent with our shared view that a robust FHA is needed to address the housing situation. However, it is essential that Congress not legislate specific underwriting criteria that would unnecessarily limit FHA's flexibility.

Certain bedrock principles also need to be maintained. For example, we require that an eligible family live in the FHA-insured home and have documented, verifiable income. That is something that FHA has always done, but in the era of no-doc loans, was a bit of an anomaly. As you know, Madam Chair, many of the problems in the housing market have occurred as a result of lax underwriting standards, and FHA should not be forced legislatively to compromise its fundamental criteria at the future expense of the taxpayer.

With all of this in mind, yesterday HUD announced some further administrative steps that will extend FHA opportunities to more homeowners. These efforts, using current regulatory authority, have extended FHA to the limit of what it can safely and prudently do under its authorizing legislation.

Let me be more specific. Yesterday, at a hearing before the House Financial Services Committee, I announced a plan to help break the cycle of foreclosures. This new plan is targeted to distressed homeowners struggling to make their current mortgage payments and have no place to turn to refinance their loans as their homes lose value.

By tapping into its existing authority, FHASecure will now serve borrowers in subprime ARMs who have gone in to default as the result of some extenuating financial circumstance that has temporarily hindered their ability to afford their existing mortgage payments. These borrowers would still have sufficient income to make payments on the new FHA mortgage, but are stretched or unable to meet the terms of their existing mortgage. The refinance will put them in a sounder financial position. Borrowers who meet FHA's other underwriting criteria but have missed two monthly mortgage payments, either consecutively or at two different times over the previous twelve months, will qualify for a standard 97 LTV loan. For borrowers who cannot meet these standards, FHA will permit up to 3 months of delinquency, again, which could be a consecutive 90-day late period or three 30-day late periods.

But, FHA will limit the LTV ratio for these borrowers to 90 percent. The 10 percent equity cushion, along with the required premiums, will protect taxpayers against unnecessary risk.

Last August, FHASecure was targeted to help creditworthy homeowners who faced a rate reset. We have now helped over 150,000 homeowners refinance into a safer option. Now, expanding FHASecure to additional borrowers will offer lenders a refinancing alternative that makes voluntarily write-downs a viable option.

Madam Chairwoman, reducing the principal amount owed on subprime mortgages helps both troubled borrowers and lenders. Borrowers would reduce their principal payments and get to keep their homes. Lenders avoid taking a more significant loss at foreclosure. Neighbors avoid vacant homes in their neighborhood, depressing their home values. And localities keep a viable tax base to fund community health, schools, and other valuable services.

FHA underwriting standards will minimize the risk of helping more families use FHASecure to keep their homes. Let me emphasize that last point. FHA will ensure borrowers have the capacity to repay their mortgages, regardless of their current credit score or potential delinquency on their existing mortgage, and will ensure the borrower did not make misrepresentations on their application. Borrowers must also show a reasonable credit history, show employment history, and have some personal equity in the deal, and fully document and verify their income. Borrowers will be required to pay upfront and annual premiums on their loans, which directly contribute to the soundness of FHA's insurance fund and protect taxpayers. Since more than 90 percent of FHA-backed loans are 30-year fixed rate mortgages, this gives us predictable, stable income.

I want to also stress this: all the changes to FHASecure we have implemented or about to implement will help us reach about 500,000 homeowners in total by the end of this year.

Of course, the President's stimulus package is also making a difference. By temporarily increasing FHA loan limits, we can back more mortgages in high-cost States and help homeowners hold on to their houses. The new loan limits were announced last month, and I have spoken with many people in the housing industry who believe that this action will quickly assist many.

FHA MODERNIZATION

For the last 2 years, the administration has suggested ways to improve the agency's ability to fulfill its mission to help low-income and first-time homebuyers who are not served by the conventional mortgage market. I believe FHA should remain true to its mission. FHA Modernization is one constructive step, a step I know you have strongly supported. And I want to thank the subcommittee for that bipartisan support. The administration continues to urge Congress to reach agreement on a bill to modernize FHA that the President can sign it into law.

However, there are two key components that must be part of any final FHA Modernization bill.

First, we must maintain FHA's ability to offer a fair and equitable mortgage insurance premium structure that is commensurate with the risk presented by the loans it insures. Any bill must give FHA the tools needed to price for additional risk. Unfortunately, neither the House (H.R. 1852) nor Senate (S. 2338) provisions succeed in accomplishing this. Instead, the Senate bill would impose a 12-month moratorium on HUD's proposed modification to the current FHA premium structure. To ensure the solvency and continued operation of FHA's single family mortgage insurance fund, flexible risk-based premiums are necessary both now and in the future.

Over the next several months FHA plans to implement a risk based premium structure administratively, up to our 2.25 percent cap. We hope that Congress will modify the bills to support this effort to permit FHA to continue to be a self sustaining Government agency. As you know, few Government programs can claim the same. We do not want to cross that line, particularly at a time when we are most needed, and as I have testified to other committees, reforms or changes to the program are already needed to avoid crossing the line in October at the start of fiscal year 2009.

Second, legislation must include a provision, like that in S. 2338, to expressly prohibit down-payment assistance from the seller or any other person or entity that stands to benefit from the transaction financially. Insured loans relying upon seller-funded down payment assistance have been demonstrated to have an unacceptably higher risk of default and foreclosure—harming borrowers they intend to help and risking the integrity of the entire FHA program and its ability to help more at-risk low- and moderate-income homeowners. Data clearly demonstrates that FHA loans made to borrowers relying on seller-funded downpayment assistance go to foreclosure at three times the rate of loans made to borrowers who make their own down payments. We simply cannot sustain this business. We want FHA to be here not just for this generation, but for generations to come.

FHA Modernization has bipartisan support. It is the appropriate next step to address the housing downturn. Congress needs to make this important bill an immediate priority over other housing proposals that are under consideration. As a first order of business, a good FHA Modernization bill must be sent to the President. We need FHA modernization as soon as possible. Every day of delay places qualifying homeowners at unnecessary risk.

DOWNPAYMENT ASSISTANCE

That is why it is extremely important to make the right choice on downpayment assistance. I know there is legislation under consideration that would ban seller-funded downpayment assistance. Yes, it should be banned. That would be a good thing to do.

As you know, in September, FHA proposed a rule to clear up this situation. Because of court action, the rule has not been implemented. But I believe our approach is sound. The FHA rule proposed in September preserves HUD's long-standing policy of permitting FHA-insured borrowers to rely on downpayment assistance from family members, employers, governmental entities, or charitable organizations. It also preserves HUD's long-standing policy of permitting sellers to contribute up to 6 percent of the sales price toward the buyer's actual closing costs, prepaid expenses, discount points and other financing concessions, such as temporary interest rate buydowns. It clarifies that the downpayment funds cannot be derived from sellers—directly or indirectly—or any other party that stands to benefit financially from the purchase transaction. Of course, nonprofits can still play a role in providing downpayment assistance in the form of a gift as long, so long as they do not collect "donations" from sellers, who have a financial stake in the sales transactions.

The administration does not support seller-funded downpayment assistance. That practice is nothing but a financial shell game where the seller wins and the homebuyer often loses. The FHA rule on down payments helps to maintain the integrity of our process and is crucial to the work of FHA. Our rule puts an end to a type of self-serving, circular-financing arrangement. It avoids the harmful effects on homeowners and the housing market.

By closing this loophole, FHA will help prevent more people from being steered into a situation where they do not understand the fine print and end up being foreclosed upon. Closing this loophole also helps ensure the financial health of the fund. FHA operates as a negative credit subsidy program, which means that it does not require Federal appropriations for its credit subsidy cost. Rather, the FHA program is funded through insurance premiums that homeowners pay themselves. However, the continuation of seller-financed downpayment assistance loans ensured by FHA threatens to force the fund into a positive credit subsidy for fiscal year 2009. We must ensure that the financial solvency of the Fund is not compromised. I really want to stress this last point . . . the financial solvency of the fund must not be compromised.

In other words, the administration would welcome a legislative ban on the practice of seller-funded downpayment assistance. That would be a prudent action. And I am hopeful that the court injunction against the FHA proposed rule will be lifted, allowing us to put in place the regulatory action that will protect homebuyers and preserve the integrity of the FHA process.

CONCLUSION

Madam Chairwoman, in conclusion, promoting homeownership remains one of the central goals of this administration, and I know it is a goal you share. We are proud of the fact that millions of new homeowners were created since the start of the decade.

We believe FHA has a role to play, provided it remains within our mission and we maintain its fiscal integrity so that it is here for future generations.

Thank you again for inviting me to testify today.

Senator MURRAY. Mr. Wade.

STATEMENT OF KENNETH D. WADE, CHIEF EXECUTIVE OFFICER, NEIGHBORWORKS AMERICA, WASHINGTON, DC

Mr. WADE. Thank you, Chairman Murray and Ranking Member Bond and members of the subcommittee. My name is Ken Wade, CEO of NeighborWorks America. I am pleased to be able to talk to you today about some of the things that we are doing to respond to this very challenging crisis we have before us.

First, I would like to commend the subcommittee for its leadership in providing the $180 million for the National Foreclosure Mitigation Counseling Program. It is essential that resources are provided to counselors so that they can work with borrowers and help prevent foreclosures in those cases where that is possible. This was the first and most significant resource actually to be provided for this purpose.

We were named to administer this program, and the legislation required that we were to disburse $167 million directly to qualifying counseling organizations that were providing mortgage foreclosure mitigation assistance, primarily to States and areas of high default rates and foreclosures primarily in the subprime housing market.

We also would like to thank HUD and their staff for assisting us in designing the program.

We are pleased to be able to report that we were able to award $130 million within 60 days of enactment as we were required to do a minimum of $50 million in that time frame, and we were successful in being able to do much more than that. I think that demonstrates the significant demand for this resource. As I said earlier, it is the only dedicated resource out there to support folks who are doing some very heroic things out there in the communities to prevent foreclosures.

We were able to award $130 million to 130 organizations. All of them are HUD-approved organizations, whether they be State housing finance agencies or NeighborWorks organizations. And then there is another $5 million that was set aside to support our counselor training, and we are pleased to be able to report that to date we have already been able to train 475 people as a result of this resource.

We identified this issue of rising foreclosures over 4 years ago. That led us to set up our Center for Foreclosure Solutions. We are doing a number of things, encouraging borrowers to reach out for assistance before it is too late. We have got a public awareness campaign that we have launched through the Ad Council that is designed to increase consumers' awareness that they can seek assistance and get that in order to prevent a foreclosure. One of the reasons that we did that is because historically up to 50 percent of all consumers who went to foreclosure had no contact with their servicer. So, obviously, you cannot do anything with a consumer unless they come in to get assistance.

We are also working to ensure that the FHA products are broadly available to the counselors and the folks that we work with. It is a critical new resource, the FHASecure program. I know that the FHA has recently announced some additional changes that we think will be critically important to serve more consumers, and so we are pleased to hear the commissioner's latest proposals in that regard and look forward to working with them very closely in that case.

We are offering through our own secondary market the FHASecure program. So we expect that we will be cooperating with the FHA in that regard.

And then just in the remaining time, let me just say that in closing let me just highlight a few remaining challenges that we are seeing. Five of those right quickly.

There still appears to be the lack of responsiveness on the part of servicers, given the scale and scope of the problem. Our foreclosure counselors continue to experience significant levels of lack of flexibility, lack of ability to contact servicers in a systematic way, and lack of clarity about the rules that govern what is available to help consumers. So everything is pretty much on a one-off basis which makes it very difficult to scale up.

Number two, there continues to be an unequal distribution of the foreclosure counseling efforts. Obviously, there are still underserved areas and populations, and through the awards that we recently made, there are still—particularly in rural areas and linguistically isolated populations—insufficient resources to meet that demand.

PREPARED STATEMENT

There is disparate impact of the foreclosure problem on low- and moderate-income and minority communities, and that is particularly troubling and something that we need to pay attention to.

And there are increasing rescue scams taking advantage of people who are in foreclosure.

So let me just wrap up with that, and I look forward to answering any questions the subcommittee might have.

[The statement follows:]

PREPARED STATEMENT OF KENNETH D. WADE

Chairman Murray, Ranking Member Bond and members of the subcommittee, my name is Ken Wade, and I am CEO of NeighborWorks America. I appreciate the opportunity to talk with you today about the mortgage crisis and some of the actions that NeighborWorks America has taken in addressing the problem.

By way of background, NeighborWorks America was established by Congress in 1978 as the Neighborhood Reinvestment Corporation. As you know, the Corporation receives a Federal appropriation from the Transportation, Housing and Urban Development, and Related Agencies Appropriations Subcommittee. For fiscal year 2008, the Corporation's appropriation is $119.8 million, in addition to a targeted amount of $180 million for foreclosure prevention counseling grants. The corporation's Board of Directors is made up of the heads of the Federal financial regulatory agencies (the Federal Reserve; the Federal Deposit Insurance Corporation; The Comptroller of the Currency; the Office of Thrift Supervision; the National Credit Union Administration) and the Secretary of HUD.

NeighborWorks America's primary mission is to expand affordable housing opportunities (rental and homeownership) and to strengthen distressed urban, suburban and rural communities across America, working through a national network of local community-based organizations, known collectively as the NeighborWorks network.

The NeighborWorks network includes 234 nonprofit organizations, serving more than 4,450 communities across the United States—in all 50 States, the District of Columbia and the Commonwealth of Puerto Rico. NeighborWorks organizations operate in our Nation's largest cities and in some of its smallest rural communities.

NeighborWorks organizations provide a wide variety of services that reflect the needs of their neighborhoods and communities, and in recent years, with the generous support of Congress, NeighborWorks has:

—Provided homeownership counseling to more than 500,000 families;

—Assisted nearly 150,000 families of modest means to become homeowners (of which, 91 percent are low-income and 53 percent are ethnic/racial minorities); and

—Provided nearly 50,000 professional training certificates to community development practitioners from over 5,000 organizations and municipalities nationwide.

NeighborWorks organizations also own and manage more than 65,000 units of affordable rental housing.

In fiscal year 2007 alone, the NeighborWorks network generated more than $4.25 billion in direct reinvestment in distressed communities across the Nation.

Today, my testimony will focus on the precipitous rise in foreclosures and the essential role that FHA and others have to play in providing tools to not only keep families in their homes, but also advance more sustainable, livable communities. The problem of foreclosure is complex, and we don't believe any single solution will eliminate the threat, but the scope and scale of the crisis demands intervention at the Federal, State and local level.

The number of loans that entered into the foreclosure process hit an estimated 1.5 million nationwide in 2007, according to an analysis of data from the Mortgage Bankers Association conducted by NeighborWorks America's Applied Research division. While more than three quarters of all existing loans were prime, subprime loans accounted for more than half (54.6 percent) of all foreclosure starts. Approximately 823,000 subprime loans started the foreclosure process in 2007, compared to 534,000 prime loans, even though there were six times as many prime as subprime loans being serviced.

It's clear that when homes go into foreclosure, the impact reaches far beyond the individual tragedies confronting homeowners who lose their home. Foreclosed homes can threaten the stability of entire communities. As foreclosed properties are abandoned, crime rates increase. The value of surrounding homes declines and other homeowners will have difficulty selling or refinancing their homes, leading to further disinvestment in communities. As a result, property taxes collected will be lower, affecting schools and government services, creating a downward spiral that is detrimental to the entire community.

A report (The Impact of Single-Family Mortgage Foreclosures on Property Values, by Dan Immergluck and Geoff Smith) demonstrated that a single foreclosure reduces total surrounding property values within an eighth of a mile radius by .9 percent. Cumulatively, this means that the foreclosures analyzed in this study resulted in average property value losses between $159,000 to $371,000 per foreclosure. Multiple foreclosures in an area compound the reduction in property values of surrounding homes even further. Another study, The Municipal Cost of Foreclosures: A Chicago Case Study, by William C. Apgar and Mark Duda) reports that one foreclosed property can end up costing a municipality as much as $34,000. Furthermore, lenders report that each foreclosure can cost them from $35,000 to $58,000.

Indeed, the negative impacts of foreclosure are now reverberating throughout the entire U.S. economy—and all projections indicate the problem is going to worsen.

I want to commend the Committee for its leadership in providing $180 million for the National Foreclosure Mitigation Counseling program which gives borrowers facing foreclosure the opportunity to work with trained counselors and their servicers and, hopefully, work through problems that would otherwise result in the loss of their homes and even further losses to the communities they live in.

NeighborWorks America was named in the fiscal year 2008 Consolidated Appropriations Act to administer the National Foreclosure Mitigation Counseling program. The legislation requires that NeighborWorks America grant at least $167,800,000 to qualifying organizations that provide mortgage foreclosure mitigation assistance primarily in States and areas with high rates of defaults and foreclosures primarily in the subprime housing market. These funds are targeted to provide foreclosure mitigation counseling to help eliminate the default and foreclosure of mortgages of owner-occupied single-family homes that are at risk of foreclosure. NeighborWorks America received grant requests totaling nearly $350 million, demonstrating a very high demand for resources to support foreclosure counseling services.

On February 26, 2007, NeighborWorks America announced National Foreclosure Mitigation Counseling program grants totaling $130,438,408 to 130 organizations (including HUD-approved housing counseling intermediaries, State Housing Finance Agencies, and NeighborWorks organizations.)

SUMMARY OF NATIONAL FORECLOSURE MITIGATION COUNSELING PROGRAM APPLICATIONS

	Number of Applicants	Number Awarded Funds	Dollar Amount Requested	Dollar Amount Awarded
State Housing Finance Agencies	36	32	$69,978,778.68	$38,664,516.00
HUD-Approved Housing Counseling Intermediaries	17	16	254,138,123.50	80,356,391.00
NeighborWorks Organizations	90	82	23,854,667.00	11,417,501.00
Totals	143	130	347,971,569.18	130,438,408.00

Up to $5 million in National Foreclosure Mitigation Counseling funds is being used to build the capacity of mortgage foreclosure and default mitigation counseling agencies.

We anticipate awarding more than 3,000 certificates for foreclosure prevention counseling training through the National Foreclosure Mitigation Counseling program. More than 475 people have been trained already this calendar year. This training builds on NeighborWorks America's existing training programs, which issued more than 12,000 training certificates to community development professionals in fiscal year 2007.

NeighborWorks® America strives to be at the forefront of issues affecting the community development field. The Corporation identified the problem of rising foreclosures over four years ago and created the NeighborWorks Center for Foreclosure Solutions, which is an unprecedented partnership between leading nonprofit organizations as well as State, local and Federal agencies and members of the mortgage lending and servicing sectors that involves a comprehensive, multi-faceted approach to the foreclosure crisis.

NeighborWorks America has been working in partnership with the Homeownership Preservation Foundation to support a national toll-free Homeowner's HOPETM Hotline for borrowers facing foreclosure (888–995–HOPE). The HOPE NOW Alliance has embraced the HOPE Hotline as a key component of their outreach and counseling efforts. The hotline provides high quality telephone-based assistance (in English and in Spanish) around the clock. Individuals needing more intense service than can be provided over the phone are referred to local NeighborWorks organizations or other HUD-approved housing counseling agencies.

We know that early intervention is critical for helping borrowers at risk of foreclosure. To encourage borrowers to reach out for assistance before it is too late, NeighborWorks America also launched a public awareness campaign through the Ad Council. The national public awareness campaign encourages struggling homeowners to reach out for assistance by calling the Homeowner's HOPE Hotline.

Because NeighborWorks America has been so active in foreclosure prevention over the past 4 years, the Corporation was invited to participate in the HOPE NOW Alliance, announced by the Secretaries of the Treasury and HUD in October 2007. The mission of the HOPE NOW Alliance is to preserve homeownership and prevent foreclosures through outreach to delinquent borrowers, counseling and loan workouts based on the borrower's ability to repay. The HOPE NOW Alliance is also working to improve communications between lenders and counselors to assist homeowners more efficiently and effectively. There are 27 mortgage services in the HOPE NOW Alliance and they account for over 90 percent of the subprime mortgage market.

NeighborWorks America is also providing support to our affiliated network of community-based nonprofit organizations and partnering with other national nonprofits, foundations and the public sector to develop strategies and tools to mitigate the impact of vacant and abandoned foreclosed properties on communities, especially in communities with high concentrations of foreclosure.

In May 2008, NeighborWorks will be sponsoring a symposium, Battling Foreclosure in a Changing Environment as part of the NeighborWorks Training Institute in Cincinnati, Ohio to help build awareness of the challenges and potential strategies and solutions available to communities impacted by the foreclosure crisis.

From our experience, we know that the best defense against delinquency and foreclosure is objective education and advice before the borrower begins shopping for a home and selecting a mortgage product. The most reliable and trusted home buyer counseling is provided through objective non-profit agencies (including local NeighborWorks® organizations and other HUD-approved nonprofit housing counseling agencies) that put the consumers' and the communities' interest first. We also know that homeowners' odds of success are increased even further when they have access to post-purchase counseling and homeowner education.

To ensure that consumers have access to the highest quality pre- and post-purchase homeownership counseling, NeighborWorks America, together with our partners, has developed National Industry Standards for Homeownership Education and Counseling. The National Industry Standards advance the highest quality of service across core areas ranging from competency of the counselor to performance in the delivery and recordkeeping

NeighborWorks America has been closely tracking the loan performance of the many low-income families assisted by NeighborWorks organizations over the years, particularly with the overall rise in foreclosures in the broader marketplace. These loans continue to perform well. We have not seen any significant up-tick in delinquencies or foreclosures among NeighborWorks-assisted families.

The data indicate that low- and moderate-income families can achieve sustainable homeownership through effective pre-purchase assistance and responsible loan products. Efforts to address the present foreclosure crisis should not limit homeownership opportunities for households of modest means or curtail our efforts to close the homeownership gap that persists for minority Americans.

As conventional mortgage originators have lost ground to mortgage brokers, the threat to sustainable homeownership continues to grow. Of the $2.5 trillion in mortgages taken out last year, roughly 60 percent was handled by the Nation's 120,000 mortgage brokers, up from just 20 percent in 1987. While there are many reputable and responsible mortgage brokers, the growth of this non-federally regulated sector has clearly contributed to the foreclosure crisis.

Many consumers are unaware that they should shop around for the best loan terms when purchasing a home. Instead, these borrowers choose the most expedient or readily available credit, even if the terms are not competitive. For credit-impaired borrowers the challenge is even greater, because they are often willing to accept any rate offered to secure the loan they need. Subprime and predatory lenders use these circumstances to their advantage, often steering borrowers to loans that hold a greater profit for their institution—and greater risk and cost to the borrower.

Unfortunately, many families did not have the benefit of pre-purchase education and counseling—assistance in determining whether homeownership is the right decision and what price house and what mortgage product works best for that family. Many of those families entered into situations that were not sustainable, whether due to budget, house price, mortgage product or other factors.

Studies demonstrate that women, minorities and lower-income borrowers rely on subprime lenders for a disproportionate share of mortgage and refinance loans, and are sometimes steered toward these loans even if their credit rating would qualify them for a prime loan.

At the same time, the outdated, paper-driven underwriting processes of most community-based lenders is time consuming and expensive. To compete against subprime and predatory lenders the nonprofit sector must have the tools and ability to respond quickly to meet borrower needs.

NeighborWorks is working to expand the market share of nonprofit lenders by increasing the capacity of the NeighborWorks network to directly originate first mortgages, and by providing research, training, financial support, technology tools and a secondary market to the NeighborWorks network. Several NeighborWorks organizations have been direct originators of first mortgage loans for some time. However, this is a critical area of growth for the NeighborWorks network in order to assure sustainable homeownership.

One tool that will assist the NeighborWorks network to originate mortgages is a new computer-assisted web-based solution developed by our affiliate capital corporation, Neighborhood Housing Services of America (NHSA)—known as BestFIT. NHSA has worked with private sector investors to develop BestFIT, an automated underwriting platform to provide immediate turnaround on loan approvals for low- and moderate-income homebuyers and homebuyers with non-conventional credit. BestFIT provides the NeighborWorks network and the broader community development field with a system that can get to "yes" quickly—a responsible alternative to the profit-motivated broker.

Equally important, it can offer the homebuyer options for an increasingly wide range of loan types. Starting with a line of NHSA and Fannie Mae loan products designed specifically for low-income homebuyers served by the NeighborWorks network, BestFIT is expanding to include capacity to help consumers analyze options for FHA loans, State housing finance agency loans nationwide, and other loans. BestFIT has also attracted interest from a number of municipalities, trade groups and community development organizations outside the NeighborWorks network that serve minority and low income families, and contracts are currently being developed to provide BestFIT for their use. NHSA is also exploring using BestFIT to expand access to refinancing products.

The automated features of BestFIT enable NeighborWorks organizations to reduce errors and the cost of hard copy transmission, while providing complete documentation for the loan.

BestFIT automates the process of screening nonperforming mortgage loans, and its "push-button" structure reduces the cost of entry into the mortgage market for NeighborWorks organizations and other community development entities. The result is that potential homebuyers have increased access to prudent, reasonably priced capital, and existing homeowners who find themselves in troublesome mortgage products can work with housing counselors to restructure their loans or find appropriate refinance products.

While the desire to own a home is strong across all socioeconomic groups, the responsibilities of homeownership are not for everyone. Therefore it remains important to have viable rental housing—especially units that allow a safe, stable environment—with rents affordable enough for occupants to accumulate savings.

Let me also add that from our experience, we know that FHA has played a key role in the mortgage market since its inception, but, for a number of reasons, over time has, represented a shrinking share of the overall mortgage market.

The administration's proposed FHA Modernization legislation, which is being actively worked on by the Congress, would bring about some much needed changes and would help assure that FHA can reassume its leadership role in the market place with low- and moderate-income borrowers. With the changes (some already made by FHA and others proposed) FHA can provide a meaningful alternative to some of the higher risk mortgage products that have contributed to the Nation's current alarming rate of foreclosures as well as help millions of additional low- and moderate-income families fulfill the American dream of homeownership.

In closing, I would like to highlight a few continued challenges:

In a recent speech, Secretary Paulson stated: "We have an immediate need to see more loan modifications and refinancing and other flexibility. For many families, this will be the only viable solution. The current process is not working well."

I couldn't agree more. There still appears to be a lack of servicer responsiveness to the scale and scope of the foreclosure problem. Many foreclosure counselors continue to experience a significant level of inflexibility by lenders and servicers in regard to loan modifications and refinancings. It appears that modifications and workouts are all being considered in a unique, "one-off" manner.

This problem (inflexibility) has been exacerbated by falling home prices where the loan to value ratio exceeds the present appraised value of the property that is the security for the loan in foreclosure.

One approach that should be given serious consideration would be to take the negative equity debt and place it into a subordinate mortgage to a new refinanced mortgage, where no payments nor interest are due on the subordinate debt until the property is sold. This alternative would prevent a windfall to the mortgagor if home prices eventually rise and preserves as much as possible of the investment that the investors have made in the loan that is being refinanced.

I also encourage investors and servicers to develop more standardized approaches and rules to loan modifications and to share those with the counseling community so that we can all aggressively increase the volume of successful loan modifications and workouts.

The HOPE NOW Alliance has also identified the need for a sustainable funding model for quality housing counseling. It is imperative that servicers agree to a fee-for-service model to compensate housing counseling agencies for foreclosure counselors who are meeting standards and working with thousands of borrowers to find successful solutions. Thus far, foreclosure counseling services has been almost exclusively supported by public funds and charitable grants.

There also continues to be an unequal distribution of foreclosure counseling providers across the country, resulting in underserved areas and populations. This continues to be a particular challenge in rural areas and with linguistically isolated populations.

The disparate impact of the foreclosure problem on low-income and minority communities and populations is also troubling. Studies confirm that foreclosures are much more likely to occur in predominantly minority neighborhoods, even when all other variables such as borrower credit and income are held steady. Rising foreclosure rates are currently threatening decades of gains in minority homeownership and community revitalization. Recent studies conducted in Atlanta, Philadelphia and Baltimore confirm that lower income, minority neighborhoods are at greater risk for concentrations of foreclosures.

Federal, State, local governments and nonprofits will have to continue to work together with private industry to address the foreclosure crisis.

I again thank you for the opportunity to testify and stand ready to answer any questions.

Senator MURRAY. Thank you very much.

Mr. Kittle.

STATEMENT OF DAVID G. KITTLE, CHAIRMAN-ELECT, MORTGAGE BANKERS ASSOCIATION, WASHINGTON, DC

Mr. KITTLE. Good morning, Chairwoman Murray, Ranking Member Bond. Thank you for inviting me to share MBA's views on how FHA can help address the housing crisis.

I am pleased to tell you my own first mortgage loan was FHA-insured.

I have spent over 30 years working with FHA. I originated thousands of loans to families who achieved the dream of home ownership through FHA's programs. When I started in the mortgage business, FHA programs helped serve many borrowers who otherwise would not get a loan. In 1983, when I was a loan officer, over 90 percent of the loans I closed were FHA-insured. During the latter part of the 1990s, FHA loans made up to 38 percent of our volume. In the past couple of years, only 2 percent of our business went to FHA.

My experience with the FHA program is similar to many other lenders. Financial institutions progressed, reacting quickly to the changing markets. Unfortunately during this time, FHA did not. FHA was not adapting to meet borrowers' changing needs. As a result, FHA became a bit player in the market.

MBA strongly supports FHA and believes it has a vital and important role in today's market with troubled home borrowers. FHA's relevance in providing affordable home ownership financing has been hampered by statutory restrictions and bureaucratic obstacles over the last decade. With the current situation in the market, there is a strong need for a robust and nimble FHA. FHA reform must be completed as soon as possible. FHA needs to be given the tools to respond to an ever-changing market. With the new focus on the ability of FHA to help during this housing crisis, we strongly believe and have been advocating for several years Congress should empower FHA to allow it to meet today's needs and anticipate tomorrow's.

MBA believes changes should be made in three areas. FHA needs more flexibility to introduce innovative new products, invest in technology, and manage their human resources.

MBA appreciates Congress' and the administration's thoughtful approaches to developing rescue plans that involve FHA borrowers in troubled loans. MBA is carefully reviewing the administration's proposal to expanding FHASecure and Chairman Dodd and Frank's proposals for a more extensive FHA program to keep homeowners in their homes and avoid foreclosure. It is in the best interest of the homeowner, the lender, and the community to do all that can be done to keep the borrowers in their home.

Additional personnel will also be critically necessary for FHA to meet an enhanced and enlarged mission. MBA notes with great concern in the administration's fiscal year 2009 budget proposal that the FHA Mutual Mortgage Insurance Fund threatens to go into the red next year unless changes to the existing program are made or additional appropriations are provided.

MBA agrees with the administration the FHA's Mutual Mortgage Insurance Fund would run in the black with little or no premium increases necessary if FHA reform proposals were passed this year. Specifically, GAO has mentioned the technology issue in reports on FHA modernization efforts. FHA told GAO its systems are poorly integrated, expensive to maintain, and do not fully support the agency's operations and business requirements. We urge Congress to address this critical concern.

In conclusion, FHA has an important role to play in the market in saving homes and assisting the underserved. For low and moderate income families, FHA provides borrowers the best opportunity to become successful and sustainable homeowners. However, over the past few years, the loss of market presence means we lost FHA's impact. We now know the result was some families turned to more expensive financing.

PREPARED STATEMENT

Now is the time to reverse the trend. FHA stands at a critical crossroads. MBA urges Congress to enact legislation to reform FHA and give it all the tools it needs to increase its availability to borrowers, promote consumer choice, and ensure its ability to continue serving American families.

MBA stands ready to work with you on this important issue.

Thank you for inviting me today.

[The statement follows:]

PREPARED STATEMENT OF DAVID G. KITTLE

Chairwoman Murray, Ranking Member Bond and members of the subcommittee, thank you for holding this hearing and inviting the Mortgage Bankers Association (MBA)[1] to share its views on the Federal Housing Administration's (FHA) role in the housing crisis. My name is David Kittle and I am the President of Principle Wholesale Lending, Inc. in Louisville, KY and Vice-Chairman of the Mortgage Bankers Association (MBA). MBA believes FHA has an integral role to play during the current mortgage market turmoil, and we urge Congress to complete its work on important legislative changes to the National Housing Act so FHA will continue to be a financially sound tool for lenders to use in serving the housing needs of American families.

MBA particularly appreciates the Senate's recent rapid and bipartisan response to the difficult conditions in the national economy. MBA believes the housing legislation taken up in the Senate last week which includes provisions to provide for a modern and effective FHA, mortgage revenue bonds for State housing finance agencies to provide refinance, and additional money for counseling—all things that will be of great help to struggling homeowners. This legislation is a priority for MBA and the mortgage industry, and MBA will do all it can to assist Congress' work.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

INTRODUCTION AND SUMMARY

MBA has an extensive history representing its members before Congress and a long record supporting FHA. This is MBA's first testimony on FHA in 2008 and it is astonishing to consider the scope and magnitude of events that have transpired within the housing finance system over the last 15 months. One sector after another became debilitated by a market-shaking crisis, until the entire system ground to a near standstill as creditors began losing confidence in the portfolios of their lending partners. It can be described as a "near standstill" because at one point, there were only four entities engaging in meaningful secondary market transactions—Fannie Mae and Freddie Mac (the "GSEs"), the Federal Home Loan Bank System, and Ginnie Mae. It is no exaggeration to say that as bleak as things have become, just imagine how much worse conditions in the housing finance system would be without the mortgage insurance provided by FHA and the guarantee of Ginnie Mae.

It is just this type of calamity Congress sought to avoid when FHA was created as an independent entity by the National Housing Act on June 27, 1934, to encourage improvement in housing standards and conditions, to provide an adequate home financing system by insurance of housing mortgages and credit and to exert a stabilizing influence on the mortgage market. FHA was incorporated into the newly formed U.S. Department of Housing and Urban Development (HUD) in 1965. Over the years, FHA has facilitated the availability of capital for the Nation's multifamily and single-family housing markets by providing Government-insured financing on a loan-by-loan basis.

FHA reform legislation has been on the congressional agenda for several years, and MBA has staunchly advocated its passage. This reform is urgently needed. While most lenders have been able to adapt quickly to changes in the mortgage markets, FHA has been limited in its ability to react. The needs of low- and moderate-income homebuyers, of first-time homebuyers, of minority homebuyers, and of senior homeowners have changed. FHA's programs, though, have not followed their historic path of adapting to meet these borrowers' changing needs. Even though current conditions seem bleak, there will come a day when the primary market will become vibrant and once again blossom with innovations in housing finance products and services. MBA continues to advocate for a vibrant FHA, one that will meet the challenges of today and evolve to serve its mission in the future.

In reviewing the status of FHA over the past decade, and during the current market turmoil, MBA has come to the conclusion that FHA faces severe challenges in managing its resources and programs in a quickly changing mortgage market. These challenges diminished FHA's ability to serve its public purposes, particularly in the years leading up to the collapse of the subprime market, and also made it susceptible to fraud, waste and abuse. Unaddressed, these issues will hamstring FHA's ability to address the current market situation. This would mean a return to a diminished relevance when the private market improves, leaving families served by its programs with no alternative for homeownership or affordable rental housing.

MBA proposes the following three steps to unleash FHA from overly burdensome statutory processes and restrictions, and to empower FHA with additional flexibilities to deal with the current market difficulties:

—FHA needs greater autonomy to make changes to its programs and to develop new products to better serve those who are not being adequately served by others in the mortgage market, including those homeowners who may find themselves without any other financing alternative during the current credit market crisis.

—FHA needs the ability to use a portion of the revenues generated by its operations to invest in the upgrade and maintenance of technology to adequately manage its portfolios and interface with lenders.

—FHA needs greater flexibility to recruit, manage and compensate employees if it is to keep pace with a changing financial landscape and ensure appropriate staffing up to the task of managing approximately $400 billion in insurance funds.

FHA'S RECORD

Single-family FHA-insured mortgages are made by private lenders, such as mortgage companies, banks and thrifts. FHA insures single-family mortgages with more flexible underwriting requirements than might otherwise be available. Approved FHA mortgage lenders process, underwrite and close FHA-insured mortgages without prior FHA approval. As an incentive to reach into harder-to-serve populations, FHA insures 100 percent of the loan balance as long as the loan is properly underwritten.

FHA's primary single-family program is funded through the Mutual Mortgage Insurance Fund (MMIF), which operates similar to a trust fund and has been completely self-sufficient. This allows FHA to accomplish its mission at little or no cost to the Government. In fact, FHA's operations have transferred surplus funds to the U.S. Treasury each year, thereby reducing the Federal deficit. FHA has always accomplished its mission without cost to the taxpayer. At no time in FHA's history has the U.S. Treasury ever had to "bail out" the MMIF or the FHA.

More than any other nationally available program, FHA has traditionally focused on the needs of first-time, minority, and/or low- and moderate-income borrowers. In 1990, 64 percent of FHA borrowers using FHA to purchase a home were first-time homebuyers. Today, that rate has climbed to 80 percent. In 1992, about one-in-five FHA-insured purchase loans went to minority homebuyers. That number in recent years has grown to more than one-in-three. Minorities make up a greater percentage of FHA borrowers than they do conventional market borrowers.

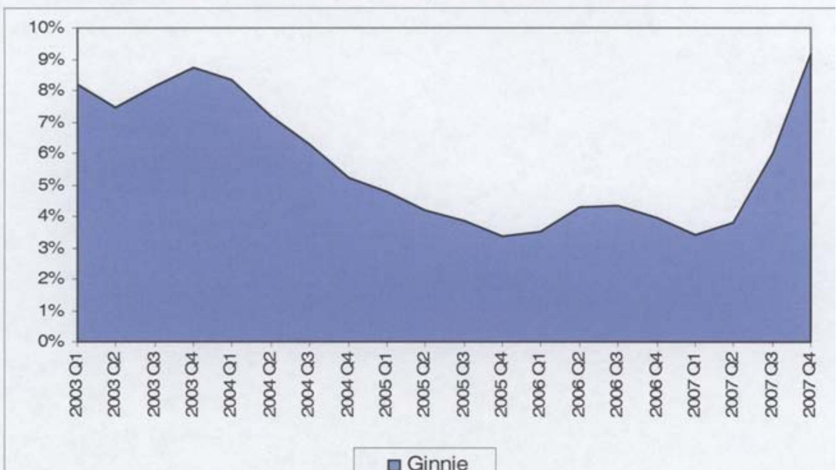
FHA is particularly important to those minority populations experiencing the largest homeownership gaps. According to recent data provided by HUD, both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. To date in fiscal year 2008, FHA has insured 159,533 purchase mortgages and 126,735, or 79.4 percent, went to first time homebuyers. Minorities have received 103,462 FHA-insured mortgages in 2008, or 28.8 percent.[2]

THE NEED FOR FHA TODAY AND TOMORROW

Only a little more than a year ago, FHA's market share was about 3 percent of total originations (see Table 1 below). MBA cites this number not because MBA believes there is a certain market share FHA should retain, but rather because this decline is consistent with many lenders' views that FHA had not kept up with changes in the market. FHA's decline gave rise to the subprime market, which quickly evolved and brought homeownership levels to historic highs.

Since July, 2007 there has been unprecedented volatility in the secondary market for mortgage loans. The market for anything but long-term fixed rate mortgages has tightened up, and investors are wary of anything outside the conforming or government arena. Both the GSEs and FHA have taken steps to protect themselves against declining market values, and tighter underwriting guidelines will remain in place for some time to come. Due to these factors, MBA believes FHA's market share is closer to 9 percent, and climbing fast.

Table 1: Ginnie Mae Share of Single-Family Securitization Market



Calculations based on data from Inside MBS&ABS

It is crucial FHA keep pace with changes in the U.S. mortgage markets. While FHA programs can be the best and most cost-effective way of expanding lending to

[2] Source: FHA Outlook, March 1–15, 2008.

underserved communities, we have yet to unleash the full potential of these programs to help this country achieve important societal goals.

To be effective in the 21st century, FHA should be empowered to allow it to develop products and programs to meet the needs of today's homebuyers and anticipate the needs of tomorrow's mortgage markets, while at the same time being fully accountable for the results it achieves and the impact of its programs.

Under the strong leadership of its current Commissioner, Brian Montgomery, FHA has undertaken significant changes to its regulations and operations. In just a little more than 2 years, FHA streamlined the insurance endorsement process, improved appraisal requirements and removed some unnecessary regulations. By doing so, Commissioner Montgomery has also instilled a spirit of change and a bias for action within FHA.

MBA compliments the Commissioner on his significant accomplishments to date, though we recognize that more work lies ahead. MBA is confident in the Commissioner's ability to address these and other issues that are within his control. There is much, though, that is beyond FHA's control and needs Congressional action.

The FHA single-family programs are vital to many homebuyers who desire to own a home but cannot find affordable financing to realize this dream. With the collapse of much of the private secondary market, FHA has become the first stop for many Americans looking to refinance their adjustable rate mortgages (ARMs). While FHA has had a number of roles throughout its history, its most important role has been to give first-time homebuyers the ability to climb onto the first rung of the homeownership ladder and to act as a vehicle for closing the homeownership gap for minorities and low- and moderate-income families.

UNLEASHING FHA'S POTENTIAL

As homeownership remains the most effective wealth-building tool available to the average American family, MBA proposes empowering FHA to manage its programs and policies more effectively.

Flexibility to Create Products and Make Program Changes

FHA programs are slow to adapt to changing needs within the mortgage markets. Whether it is small technical issues or larger program needs, it often takes many years and the expenditure of great resources to implement changes. This process overly burdens FHA from efficiently making changes to serve homebuyers and renters better and protect FHA's insurance funds. Today's mortgage markets require agencies that are empowered to implement changes quickly and to introduce or test new programs to address underserved segments of the market.

A prime example of this problem can be found in the experience of FHA in offering hybrid ARM products. A hybrid ARM is a mortgage product which offers borrowers a fixed interest rate for a specified period of time, after which the rate adjusts periodically at a certain margin over an agreed upon index. Lenders are typically able to offer a lower initial interest rate on a 30-year hybrid ARM than on a 30-year fixed rate mortgage. During the late 1990s, hybrid ARMs grew in popularity in the conventional market due to the fact they offer borrowers a compromise between the lower rates associated with ARM products and the benefits of a fixed rate period.

In order for FHA to offer this product to the homebuyers it serves, legislative approval was required. After several years of advocacy efforts, such approval was granted with the passage of Public Law 107–73 in November 2001. Unfortunately, this authority was not fully implemented until the spring of 2005.

The problem began when Public Law 107–73 included an interest rate cap structure for the 5/1 hybrid ARMs that was not viable in the marketplace. The 5/1 hybrid ARM has been the most popular hybrid ARM in the conventional market. As FHA began the rulemaking process for implementing the new program, they had no choice but to issue a proposed rule for comment with a 5/1 cap structure as dictated in legislation. By the time MBA submitted its comment letter on the proposed rule to FHA, we had already supported efforts within Congress to have legislation introduced that would amend the statute to change the cap structure. MBA's comments urged that, if passed prior to final rulemaking, the 5/1 cap fix be included in the final rule.

On December 16, 2003, Public Law 108–186 was signed into law amending the hybrid ARM statute to make the required technical fix to the interest rate cap structure affecting the 5/1 hybrid ARM product. At this point, FHA was ready to publish a final rule. Regardless of the passage of Public Law 108–186, FHA was forced to go through additional rulemaking in order to incorporate the fix into regulation. Thus, on March 10, 2004, FHA issued a Final Rule authorizing the hybrid ARM program, with a cap structure that made FHA's 5/1 hybrid ARM unworkable in the marketplace. It was not until March 29, 2005 that FHA was able to complete rulemaking on the amendment and implement the new cap structure for the 5/1 hybrid ARM product.

The hybrid ARM story demonstrates well the statutory straitjacket under which the FHA operates. A 4-to-6-year lag in introducing program changes is simply unacceptable in today's market. Every month a new program is delayed or a rule is held-up means that families who could otherwise be served by the program are prevented from realizing the dream of homeownership or securing affordable rental housing.

Ability to Invest Revenues in Technology

Technology's impact on mortgage markets over the past 15 years cannot be overstated. Technology has allowed the mortgage industry to lower the cost of homeownership and streamline the origination process. The creation of automated underwriting systems, sophisticated credit score modeling, and business-to-business electronic commerce are but a few examples of technology's impact.

FHA has been detrimentally slow to move from a paper-based process, and it cannot electronically interface with its business customers in the same manner as the private sector. During 2004 and 2005, over 1.5 million paper loan files were mailed back and forth between FHA and its approved lenders and manually reviewed during the endorsement process. Despite the fact FHA published regulations in 1997 authorizing electronic endorsement of loans, FHA was not able to implement this regulation until January 2006. This delay occurred despite the fact that over the same 8 years, FHA's operations generated billions of dollars in excess of program costs which was transferred to the U.S. Treasury.

MBA believes FHA cannot create and implement technological improvements because it lacks sufficient authority to use the revenues it generates to invest in technology. Improvements to FHA's technology will allow it to improve management of its portfolio, garner efficiencies and lower operational costs, which will allow it to reach farther down the risk spectrum to borrowers currently unable to achieve homeownership. MBA believes such an investment would yield cost savings to FHA operations far in excess of the investment amount.

In fact, some members of the Senate have taken action to address this issue by introducing and co-sponsoring S. 947, the "21st Century Housing Act," which would authorize funding to pay for much needed technology improvements. We were also pleased to support the compromise legislation introduced by Senators Dodd and Shelby last week, which included a provision to allow FHA to spend up to $25 million per year from its surpluses to pay for these improvements.

Greater Control in Managing Human Resources

FHA is restricted in its ability to effectively manage its human resources at a time when the sophistication of the mortgage markets demands market participants to be experienced, knowledgeable, flexible and innovative. To fulfill its mission, FHA needs to be able to attract the best and brightest. Other Federal agencies, such as the Federal Deposit Insurance Corporation (FDIC), that interface with and oversee the financial services sector are given greater authority to manage and incentivize their human resources. MBA believes FHA should have similar authority if it is to remain relevant in providing homeownership opportunities to those families underserved by the private markets. FHA should have more flexibility in its personnel structure than is provided under the regular Federal civil service rules. With greater freedom, FHA could operate more efficiently and effectively at a lower cost. Further, improvements to FHA's ability to manage its human capital will allow FHA to attract and manage the talent necessary to develop and implement the strategies that will provide opportunities for homeownership to underserved segments of the market.

In addition to increasing funding for technological improvements to FHA, S. 947 would call on the HUD Secretary to consult with, and maintain comparability with, the compensation of officers and employees of the Federal Deposit Insurance Corporation, thereby giving FHA tools to retain qualified and capable staff.

MBA believes the above three changes will allow FHA to effectively manage risk and self-adapt to shifting mortgage market conditions while meeting the housing needs of American families.

MBA SUPPORTED FHA MODERNIZATION PRINCIPALS

MBA has offered strong support for many pieces of FHA legislation pending before the Senate.

Raising Maximum Mortgage Limits for High Cost Areas

There is a strong need for FHA financing to be relevant in areas with high home prices. Although loan limits for 2008 were temporarily raised under the Economic Stimulus Act of 2008 ("Economic Stimulus Act"),[3] MBA supports raising the FHA's maximum mortgage limits to 100 percent of an area's median home price (except for 2008, pegged at 95 percent) and raising the ceiling to 100 percent of the GSEs' conforming loan limits (except for 2008, limited to 87 percent) and the floor to 65 percent (except for 2008, set at 48 percent). Raising the limits to the GSEs' conforming limits in these areas strikes a good balance between serving a greater number of borrowers and taking on additional risk.

Additionally, in many low-cost areas, FHA's loan limits are not sufficient to cover the costs of new construction. New construction targeted to first-time homebuyers has historically been a part of the market in which FHA has had a large presence. MBA believes raising the floor will improve the ability of first-time homebuyers to purchase modest, newly constructed homes in low-cost areas since they will be able to use FHA-insured financing.

Downpayment Requirements

MBA supports the elimination of the complicated formula currently detailed in statute for determining the downpayment. The calculation is outdated and unnecessarily complex. The calculation of the downpayment alone is often cited by loan officers as a reason for not offering the FHA product.

MBA also supports improving FHA's products with downpayment flexibility. Independent studies have demonstrated two important facts: first, the downpayment is one of the primary obstacles for first-time homebuyers, minorities, and low- and moderate-income homebuyers. Second, the downpayment itself, in many cases, is not as important a factor in determining risk as are other factors. Many borrowers will be in a better financial position if they keep the funds they would have expended for a large downpayment as a cash reserve for unexpected homeownership costs or life events.

MBA believes FHA should be empowered to establish policies to allow borrowers to qualify for FHA insurance with flexible downpayment requirements and decide the amount of the cash investment they would like to make in purchasing a home. To this end, the Secretary of HUD should be authorized to determine the appropriate level of downpayment requirements. Further, we have concerns that statutory increases in the FHA's minimum downpayment may inhibit it from performing its mission of assisting low- and moderate-income homebuyers. MBA is ready to work with Congress to ensure that such flexibility maximizes homeownership opportunities for underserved communities without compromising the safety and soundness of FHA.

Adjusting Mortgage Insurance Premiums for Loan Level Risk

MBA believes FHA would be able to serve more borrowers, and do so with lower risk to the MMIF, if it is able to adjust premiums based on the risk of each mortgage insured. A flexible premium structure could also give borrowers greater choice in how they utilize the FHA program.

Some borrowers and loans will pose a greater risk to FHA than others. At a certain level, FHA should have the authority to adjust premiums based on borrower or loan factors that add risk. Such adjustment for risk need not be a complicated formula. MBA believes FHA could significantly mitigate risk to the MMIF by selecting a small number of risk factors to adjust from a base mortgage insurance premium (MIP).

Creating a risk-based premium structure will only be beneficial to consumers, though, if FHA considers lowering current premiums for less risky loans. We would not support simply raising current premiums for higher risk borrowers.

Lengthening Mortgage Term

MBA supports FHA's ability to develop products with mortgage terms up to 40 years. Currently, FHA is generally limited to products with terms of no more than 30 years. Stretching out the term will lower the monthly mortgage payment and allow more borrowers to qualify for a loan while remaining in a product that continues to amortize. MBA supports lengthening the mortgage terms and believes FHA should have the ability to test products with these features and, based on performance and homebuyer needs, to improve or remove such products.

[3] Public Law No: 110–185.

Improvements to the Reverse Mortgage Program

Senate FHA modernization legislation should include changes to the FHA's Home Equity Conversion Mortgage (HECM) program, such as: the permanent removal of the current 250,000 loan cap and the creation of a single, national loan limit for the HECM program. The HECM program has proven to be an important financing product for this country's senior homeowners, allowing them to access the equity in their homes without having to worry about making mortgage payments. The program has given tens of thousands of senior homeowners greater freedom, allowing them to pay for such items as improvements to their homes that have allowed them to age in place, or to meet monthly living expenses without having to move out of the family home.

MBA believes it is time to remove the program's cap because the cap threatens to limit the HECM program at a time when more and more seniors are turning to reverse mortgages as a means to provide necessary funds for their daily lives. MBA further believes the HECM program has earned the right to be on par with other FHA programs subject only to FHA's overall insurance fund caps. Additionally, removing the program cap will serve to lower costs as more lenders will be encouraged to enter the reverse mortgage market.

Additionally, authorizing the HECM program for home purchase will improve housing options for seniors. In a HECM for purchase transaction, a senior homeowner might sell a property they own to move to be near family. The proceeds of the sale could be combined with a reverse mortgage, originated at closing and paid in a lump sum, to allow a senior to purchase the home without the future responsibility of monthly mortgage payments. Alternatively, a senior homeowner may wish to take out a reverse mortgage on a property that is less than 1 year old, defined as "new construction" by FHA.

Finally, the HECM program should have a single, national loan limit equal to the limit of FHA's forward programs. Currently, the HECM program is subject to county-by-county loan limits that are exempt from the higher loan limits implemented under the Economic Stimulus Act.[4] HECM borrowers are disadvantaged under this system because they are not able to access the full value of the equity they have built up over the years by making their mortgage payments. Currently, a senior homeowner living in a high-cost area is able to access more equity than a senior living in a lower cost area, despite the fact that their homes may be worth the same and they have the same amount of equity built up. Reverse mortgages are different than forward mortgages and the reasons for loan limits are different, too. FHA needs the flexibility to implement different policies, especially concerning loan limits.

ADDITIONAL ISSUES

Treatment of FHA Non-Conveyable Properties

FHA provides credit insurance against the risk of foreclosure losses associated with loans originated according to FHA standards. FHA generally pays an insurance claim when it takes title (conveyance) to a property as a result of foreclosure. To convey a property and receive insurance benefits, however, FHA requires the property be in "conveyance condition" (i.e., saleable condition). Properties that have sustained damage attributable to fire, flood, earthquake, tornado, hurricane, boiler explosion (for condominiums), or the lender's failure to preserve and protect are not eligible for insurance benefits unless they are repaired prior to conveyance of the property to the FHA. While HUD has in the past accepted properties in "as is" (damaged) condition on a case-by-case basis, this is rarely done. Moreover, HUD will deduct from the "as is" claim the estimated cost of repair. HUD should accept conveyance of damaged properties and not adjust the claim for the cost of repair when there was no failure on the part of the servicer to obtain hazard or flood insurance pursuant to Federal law or if a borrower is eligible to apply for CDBG grant funds, but fails to do so. In addition, to the extent that a property is not conveyable (i.e., condemned, demolished by local, State, or Federal Government or deemed to be a Superfund site, etc.), HUD should be permitted to pay the full claim without taking conveyance of the property. We do not believe HUD currently has the statutory authority to manage claims in this manner.

Last year, the House passed H.R. 1227, the "Gulf Coast Hurricane Housing Recovery Act of 2007," which includes a provision dealing with this issue. Following that action, Chairman Dodd introduced S. 1668, the Gulf Coast Housing Recovery Act of 2007, which also includes a fix to this serious problem. MBA applauds Congress' attention to this issue, especially in light of HUD's and Louisiana's actions to re-

[4] Public Law No: 110–185.

vamp the Road Home grant program in a manner that no longer promotes rebuilding. This decision exacerbates servicers' losses. These are losses FHA lenders never thought they could incur, and that represent a significant cost for FHA financing.

Mortgage Broker Supervision

FHA must approve all mortgage lenders and loan correspondents who wish to originate or underwrite FHA-insured loans. Non-supervised mortgagees (e.g. mortgage brokers) and loan correspondents outside of the Federal regulatory regime must establish an ability to meet both FHA's financial and legal standards in order to be approved. This is currently satisfied through a minimum net worth requirement and the submission of a yearly financial audit demonstrating the mortgagee or loan correspondent not only has a certain level of financial solvency, but also employs necessary controls to provide reasonable assurance FHA products are offered in compliance with all applicable regulations, such as laws governing fair housing and nondiscrimination.

Although MBA supported passage of comprehensive FHA reform (H.R. 1852) which passed in the House of Representatives last year, we oppose a provision contained in the bill which would alter this approval process by allowing mortgage brokers to substitute a surety bond in lieu of the existing annual net worth auditing requirements. It is important to note the annual financial statement (AFS) is the Federal Government's only opportunity to ensure that the 7,500 non-supervised mortgagees, loan correspondents, and brokers who offer FHA-insured loans are doing so in accordance with all applicable laws and regulations. Kenneth Donohue, HUD's Inspector General, stated "[t]he AFS is an integral part of FHA's monitoring of its approved mortgagees, and [the Inspector General] does not believe that its minimal cost . . . is sufficient cause to increase the risk of loss to the taxpayer that may result from its elimination." MBA believes in the current climate of rising FHA defaults, this is not the appropriate time to loosen the supervision of entities offering products backed by FHA and the American taxpayer.

FHA Multifamily Programs

While the thrust of recent modernization efforts focus on FHA's single-family programs, it is very important to underscore the critical role of FHA's multifamily programs in providing decent, affordable rental housing for many Americans. Approximately 30 percent of families and elderly citizens either prefer to rent or cannot afford to own their own homes. FHA's insurance of multifamily mortgages provides a cost-effective means of generating new construction or rehabilitation of rental housing across the Nation. FHA is also one of the primary generators of capital for healthcare facilities, particularly nursing homes.

Congress has moved decisively over the past year on a number of issues affecting the FHA multifamily programs. Last fall, Congress passed legislation to raise the mortgage limits in high-cost areas in response to rapidly rising building costs in many of the Nation's cities. And HUD responded quickly with regulations implementing those higher limits, allowing lenders and developers to continue to provide affordable housing in those areas that need it the most.

Congress also was instrumental in convincing the administration to abandon their planned increase in the Mortgage Insurance Premium (MIP) for FHA multifamily mortgages. The proposal, if implemented, would have increased prices on multifamily development precisely at the time when the production and preservation of affordable rental housing is under stress from the same capital market crisis that is affecting the single family housing markets. To assure future administrations do not try to use the FHA multifamily programs to raise money for other priorities, we urge Congress to pass legislative language, included in both House and Senate FHA reform bills. The provisions would prohibit HUD from increasing multifamily mortgage insurance premiums unless the increase is necessary to cover the costs of the program, though we prefer the House version which extends for a longer period of time.

It should also be noted the FHA multifamily programs need funds for technology improvements similar to the single family programs. HUD currently has a number of systems to automate important processes (e.g. the previous participation process and multifamily property inspections) that simply do not work effectively because funds are needed to update and streamline the processes. Without technology funds, processes that should be automated—to save HUD staffing costs and improve oversight of the programs—will remain overburdened with paper and less effective than needed. Additional technology funds should thus be allocated to the multifamily programs, as well as the single family programs.

CONCLUSION

Finally, as Senators on this subcommittee are well aware, recent unrest in the mortgage industry has led to a number of lenders either significantly tightening underwriting standards or leaving the business altogether. MBA believes the individuals who will be most directly impacted by these events are the consumers FHA was created to serve: first-time homebuyers, low-income families, and those with less than perfect credit histories. It is in light of these realities that MBA urges Congress to move quickly and empower FHA with the authority it needs to provide these consumers with affordable, viable lending options needed to help them achieve homeownership.

MBA would like to thank this subcommittee for the opportunity to present its views on FHA. MBA looks forward to continuing to work with Congress and HUD to improve FHA's long-standing mission and ability to serve aspiring homeowners and those seeking affordable rental housing.

FHASECURE

Senator MURRAY. Thank you very much to all of you for your testimony.

Mr. Montgomery, I am going to start with you. The administration has undertaken two initiatives targeting the subprime crisis. You talked a little bit about them, the FHASecure program and the HOPE NOW Alliance, and you announced yesterday that you are planning to expand the FHASecure program. You are proposing to allow riskier borrowers to participate in the program, the borrowers that may have more troubled credit history, and you are planning to guarantee loans to these borrowers at 90 percent instead of 100 percent of their home's appraised value. I wanted to ask you, do you really think that this new initiative will bring in a meaningful number of borrowers?

Mr. MONTGOMERY. Thank you for your question. We estimated that on top of the 300,000 we believe that we will do with FHASecure, by the end of the fiscal year, and the 400,000 that we will—add 100,000 to that number, to the end of the calendar year and add another 100,000 we think through the expansion we announced yesterday, for a total of 500,000. So in between moving the fence line out, if you will, about delinquencies and/or the write-down of principal to 90 percent, yes, we think we will help about 100,000.

I want to add, as you know, we announced FHASecure August 31, of last year, and while we have helped 153,000 folks refinance, the number that were delinquent has been very little, around 2,500. The reason we heard from applicants—because we have had 330,000 apply—is that they might have had one or two delinquencies. So we think this is a measured way to take into consideration some folks that hit an economic rough patch, they had an illness, or whatever, and that it is a good measured approach to expand FHASecure.

Senator MURRAY. Mr. Kittle, do you expect the lending community to participate in this new program even though it will only guarantee 90 percent instead of 100 percent of the home's current value?

Mr. KITTLE. Referring to the proposal that he just made last night?

Senator MURRAY. Yes.

Mr. KITTLE. We would like to evaluate it further since we have not had time to look at it. But I would anticipate that we will look at it quickly and come out with a comment on it very quickly.

Senator MURRAY. Well, one of the things I am concerned about is that lenders will require homeowners to borrow additional amounts outside of the FHA to make up for the amounts that the FHA is not willing to guarantee. If that occurs, which is likely, how do we make sure these secondary loans are not the same type of risky loans that got the borrower into trouble in the first place?

Mr. KITTLE. Is that to me?

Senator MURRAY. Mr. Kittle or Mr. Montgomery. Mr. Kittle, I will start with you.

Mr. KITTLE. Well, are we talking about subordinate financing, outside the down payment?

Senator MURRAY. Right.

Mr. KITTLE. If this is done and enacted, then those subordinate loans should be included in the underwriting guidelines. FHA has prudent underwriting guidelines, and if they are adhered to, then we should be making good loans. Historically they have made very good loans under the FHA program. So if they are underwritten properly, then they should be okay.

SUBORDINATE LOANS

Senator MURRAY. Mr. Montgomery?

Mr. MONTGOMERY. What we envision is again through the 90 percent LTV, the lender, the service writes it down—and this is largely for borrowers who are underwater. They write it down to the amount that we will only insure 90 percent of. That 10 percent—let me just give you an example.

The original mortgage was $120,000. The home is now worth $100,000. FHA says, okay, we will insure 90 percent of that. Right now, we do 97 percent. Ninety percent LTV loans perform very well in the FHA portfolio. So the existing servicer or lender can write it down to $100,000 and put the 10 percent in a second lien. They can write it down all the way to $90,000.

Senator MURRAY. Is this written so we will only cover underwater mortgages?

Mr. MONTGOMERY. Well, if you are delinquent—and a lot of the borrowers who are that delinquent are underwater—we are just saying FHA—going forward, we will only insure 90 percent of that. So the Government's role is 90 percent. This is a big departure from our normal 97 percent.

Senator MURRAY. I understand that, and that is what I am concerned about, that people will get secondary loans to cover that extra 10 percent.

Mr. MONTGOMERY. We do not envision that happening.

Senator MURRAY. Right. And the FHA guidelines will not apply to any secondary loans, should that occur?

Mr. MONTGOMERY. That is correct. FHA is always in a first position.

Senator MURRAY. Mr. Wade, are you concerned about these secondary loans?

Mr. WADE. Well, clearly that could be an area of challenge with the program, not having seen the specifics, but I think as Mr.

Kittle mentioned, many lenders allow secondary financing and they typically have rules that govern what is allowed in the context of that transaction. So I would assume the FHA would do a similar thing with their program.

In addition to that, there are increasing resources available at the State and local level that are called a variety of things, but rescue funds are kind of the generic category. I know in many cases local organizations have been able to tap rescue funds to make up the gap when the loan-to-value is not sufficient to be able to get a refinance done.

So we think there are ways that you can guard against that through rules that the FHA can develop and adopt.

Senator MURRAY. And you are developing those, Mr. Montgomery?

Mr. MONTGOMERY. Yes, we are developing the mortgagee letter right now. As I mentioned in yesterday's hearing, it will take about 60 to 70 days to stand this program up.

Senator MURRAY. My time is short and we have votes here shortly. I know my colleagues have questions.

Mr. Wade, I did want to thank you for bringing up the scam issue. That is what we are seeing in neighborhoods across the country, these signs on telephone poles, call 1–800, or through the Internet, and hearing stories of families that send a check for $450 thinking somebody is going to save their life. It is a real problem out there.

Senator Bond.

Senator BOND. Thanks very much, Madam Chair.

Following up on that, if you write a 90 percent loan—if you cut it back, you said you do not expect. Would you allow or disallow a lender from taking a soft second on that? And if they take a soft second, would that be one that runs only to the property or would it be a personal liability?

Mr. MONTGOMERY. It would be a non-recourse. It would be a soft second with a note due on the——

APPRAISALS

Senator BOND. Totally non-recourse. So the lender would have to agree that he would take his risk on 90 percent and hope maybe if the sun shines right and the flowers grow, that he might get the rest back. If it works, that sounds good.

Appraisals. Another thing a number of people have raised with me that appraisals have been faulty, and there are some who point fingers at appraisers. What does HUD do to ensure the appraisals are accurate?

Mr. MONTGOMERY. Are you talking about just in general or for our new programs or?

Senator BOND. Well, what are you doing and what do you propose to do? You are going to be doing 90 percent.

Mr. MONTGOMERY. Yes, sir.

FHASECURE EXPANSION

Senator BOND. You are going to have to guard very carefully against phoney appraisals. And we hear that a lot of phoney appraisals may have sneaked into the system and been part of the cause.

Mr. MONTGOMERY. Well, for one, on the loan limit increase done under the economic stimulus; we in fact just put out a mortgagee letter requiring two appraisals, new appraisals, especially given the high level of some of the limits.

We are, again, still putting together the mortgagee letter on the expansion of FHASecure, and one of the things that we have discussed internally is should we require two appraisals for that regardless of what the loan limit is. Again, we are still putting the finishing touches on that policy as well.

We have instituted some risk algorithms because all the appraisers have to be registered with FHA. We constantly look at their performance, those that have high defaults, those that do a lot of high-risk loans in certain areas. In fact, we have had various levels of sanctions, some very minor, some major. Since 2004 when we instituted the program, about 1,100 appraisers have been sanctioned in some way. So it is something we continue to watch and want to be ever-vigilant on.

PREDATORY LENDING

Senator BOND. One of the things I read about in the newspapers and I have heard about back home are FBI investigations of outright fraud. There may be a small handful of people who have helped spread this toxic paper who are criminally responsible, and I hope that HUD and FHA would make appropriate referrals in those instances.

I mentioned in my opening comments about predatory lending, what Senator Mikulski and I tried to do about it. Are you doing anything about predatory lending?

Mr. MONTGOMERY. Well, we continue to raise the bar. There has been a lot of effort by some groups for us to stop requiring audited financial statements, things of that nature. We want to make sure that if we approve a lender, they are working under the highest ethical and financial standards, so that we will never take off the table.

Lenders and brokers know if they are going to participate in FHA, we do have a punitive side. We have a quality assurance division that constantly does on-site monitoring. We obviously have our Inspector General who is very aggressive, as he should be, in this area. Can we eliminate all predatory lending and fraud? Unfortunately, no, but we are doing a lot——

Senator BOND. Well, there is nothing like a few high-class prosecutions and maybe one of those little signs that they have every time I check out at the supermarket. They say if you write a bad check, you are going to get prosecuted. I do not hand them any checks, but it always gets my attention in the supermarket.

Mr. MONTGOMERY. Yes, sir.

Senator BOND. You might include something like that.

Mr. MONTGOMERY. Yes, sir.

Senator BOND. Have you been actually recommending through the IG any criminal prosecutions?

Mr. MONTGOMERY. Well, our Quality Assurance Division—that is all they do, are monitor lenders.

Senator BOND. But how many have they turned over? Do you have an idea?

Mr. MONTGOMERY. I would not know right off the top of my head how many.

Senator BOND. I would be interested in that. I think that is important.

Mr. MONTGOMERY. There are a substantial number of abuses that do not rise to the level of criminal. People just got sloppy.

Senator BOND. Oh, agreed. Yes.

Mr. MONTGOMERY. And it is really the IG who takes over at that point. As you know, he is very aggressive, as he should be, in that area.

Senator BOND. Madam Chair, I am going to hand in the rest of my questions for the record because there are many things I want to hear from Mr. Kittle and Mr. Wade, as well as Mr. Montgomery. I thank you for being here, and I apologize for the Senate schedule.

Senator MURRAY. I agree with you. We have so many hearings going on and a number of votes that are going to be called shortly. And we do have critical questions for all of you. We will all be submitting questions and hope that we can get answers back from you, because these are critical issues, in a timely manner.

Senator Allard.

HUD'S WORKFORCE

Senator ALLARD. Thank you, Madam Chairman.

I would like to get to the bottom line on some of this. We have the Dodd-Frank proposal which is trying to help out distressed borrowers. If that were to become law and move forward, do you have any idea how many additional staff people would be required for that type of program?

Mr. MONTGOMERY. Within HUD?

Senator ALLARD. Yes.

Mr. MONTGOMERY. I could not give you an exact number. I will say that we have a very experienced workforce at HUD. That is the good news. The bad news is a lot of them are within retirement ages. I will give you an example. Last year, we hired 376 people, and we still finished seven below where we started the previous year. We are on track to hire another 400 this year, but again, we will more than likely finish below where we were.

Senator ALLARD. This is 400 in addition to the 360-some that you hired?

Mr. MONTGOMERY. Yes.

Senator ALLARD. So you are coming to somewhere around 760 employees.

Mr. MONTGOMERY. Yes, and 80 percent of those, give or take, are out in the field. Those are not all in single family housing. Probably about a third of them are.

Senator ALLARD. So how many do you have now in single family housing?

Mr. MONTGOMERY. Single family housing is around 800 total around the country. About half of those are in——

Senator ALLARD. So when you get finished, you are still going to have fewer employees than you have now.

Mr. MONTGOMERY. What I am describing has been a problem at HUD for some time. A lot of experienced people are just retiring.

Senator ALLARD. So if we have a new program that is initiated, it is going to call for more FTE's, is it not?

Mr. MONTGOMERY. I have made it well known—and I appreciate Mr. Kittle's remarks—that we have concerns in personnel and in IT systems as well.

Senator ALLARD. Do you have a plan as to how you are going to make up for that employee shortfall?

Mr. MONTGOMERY. Yes, we are. We are very aggressively hiring more folks. While there have been extensive layoffs in the lending industry, which is bad news, the good news is we have gotten a lot of high quality applicants who want to come work at HUD. That has been good news for us.

PART PROGRAM

Senator ALLARD. Well, in the past, HUD has struggled with being able to meet the requirements of the PART program, which is an accountability program by the President. So I am concerned as to whether we load you up with another program, how you are going to respond to that and whether you are going to be able to maintain your PART score now which is effective, I believe. That is better than where you were. So I want to compliment you for improving it, but I am concerned about loading you up and then you fall back and cannot accomplish your goals and objectives.

Mr. MONTGOMERY. As are we, Senator.

Senator ALLARD. Mr. Kittle, the Banking Committee is also holding a hearing on FHA today. Looking over the observation of one of the witnesses—and I planned on asking this question in that committee but with the change, we decided to spend our full time here because of the vote coming up.

And there was a quote that said in more cases, foreclosures will occur because falling prices push home values below mortgage amounts, and people struggling to make their mortgage payments decide to stop struggling. I think this is a significant change. Previously I think borrowers felt a moral obligation to make payments and that there was a stigma with that default in their obligation. It was a promise; so to speak, broken that happened if they did not keep up with their loan payments. And it was rare for families, in a sense, to choose foreclosure.

How much has the attitude shift factor into the foreclosure rates we are seeing today?

And then the second question is how do we prevent rewarding those who may simply decide to stop paying as compared to those who have made very difficult choices to honor their obligations?

Mr. KITTLE. The first part of your question. I think it is probably pockets of the country where you may see this type of attitude taking place, probably in six or seven States, Arizona, Nevada, California, Florida, Michigan, places like that. The Midwest and the heartland of the country—we still see flat or appreciating home prices in many areas. So as the media professes what is going on, sometimes it becomes a self-fulfilling prophecy. We do not see a blanket of people walking away from their homes. It is in pockets.

The second part of your question, we do not need to make it easy for people to file bankruptcy. We do not need, just as an example, cram-down legislation which will let people include their homes in bankruptcy. It makes it too easy for them to do that. We need to get back to personal responsibility in this country. And that is what we stand for and we will stand against that particular provision going forward. And I hope that answers your question.

Senator ALLARD. I think we need to deal with those that are struggling and we need to be concerned about increased liabilities on FHA. So I am concerned about how you are going to filter out those who are borrowers who did misdeeds and if we are looking at a program such as the Dodd-Frank program where we are focusing on—there are the lenders and the borrowers. They are focusing on the borrowers. How do we separate those that are being responsible in their action and those that are not being responsible? That is my concern.

Mr. MONTGOMERY. Do you want me to respond to that?

Senator ALLARD. Please.

Mr. MONTGOMERY. One thing that we are not changing is our rigorous payment-to-income ratios, our debt-to-income ratios. We are keeping those rigid. The Frank proposal—I assume the Dodd is the same way. They come at it with a much higher DTI ratio on the front end.

Senator ALLARD. DTI?

Mr. MONTGOMERY. I am sorry, debt-to-income ratio.

They come at it a little differently. We are coming at it from the way of delinquencies, meaning the borrower missed a couple payments. They made up those payments. That shows us that they are serious about trying to stay in that home. And as you know, we verify income. We verify how long you have been on your job. Those corners we are not cutting. This, again, tells us these borrowers are serious about trying to stay in their homes as opposed to some who just give up and just walk away.

Senator ALLARD. Thank you.

RISK TO FHA

Senator MURRAY. Thank you very much.

Mr. Montgomery, the current FHASecure program requires a borrower to have made all of their mortgage payments for 6 months prior to their interest rate resetting upward. The new proposal that you have to expand FHASecure would allow borrowers that already missed some payments before their interest rate went up to now participate in that program.

Do you think that someone who has been delinquent on their mortgage payments before their interest rates went up represents an appropriate risk for FHA?

Mr. MONTGOMERY. Well, there are some that said that we should go even more than that, and I want to stress they were late making the payments, but they did make the payments, which again shows us they do want to stay in their house.

Senator MURRAY. So it is not just that they missed the payments, they have made those payments?

Mr. MONTGOMERY. They did make them. They just made them late up into the point of the reset. Now, after the reset, they may have missed some payments, but again, once they refinanced, especially if they are doing a write-down of principal, those payments could be written into the new loan or the lender, whoever is holding the note now, may now just extinguish those.

Senator MURRAY. Can you tell us what protections you are putting in place so that you are not taking on a greater risk?

Mr. MONTGOMERY. Well, again, some of what I articulated with Senator Allard. We have very vigorous underwriting. This is not something we are proud of, but historically there is a reason people come to FHA. And if you look at our default ratio through the years, it has been high, although I will say it is lower now, because borrowers historically who use FHA do miss payments. They ultimately make them, but these are lower income borrowers with an average income of $50,000 a year, an average mortgage amount on the purchase side of about $150,000. And that historically is what FHA borrowers have done. We do have experience in dealing with borrowers who are late on payments.

Senator MURRAY. Mr. Kittle, you wanted to make a comment?

Mr. KITTLE. Yes, Senator Murray.

I am a DE underwriter, although I have not practiced it a lot in the past few years, but I can tell you one of the strengths of the FHA program is that it required documentation. It required verification. So if somebody comes and the loan is presented to the underwriter and they have been delinquent, there are reasons we ask and verify. They may have had a temporary job loss or a temporary layoff. Unemployment benefits ran out. And if that can be verified and they have reestablished a job, then that is every reason to give them a chance to go forward.

And if I may respond to Senator Bond just for a second on the appraisal issue, I can assure you right now on the conventional and the FHA and the VA side, because of what has happened in the mortgage market, appraisals are being scrutinized like they have never been before.

MUTUAL MORTGAGE INSURANCE (MMI) FUND

Senator MURRAY. Well, let me go back to you, Mr. Montgomery. HUD's budget assumes that there are going to be three major reforms to the FHA single family housing program. I am told that if these reforms are not enacted this year, the Mutual Mortgage Insurance (MMI) fund could potentially face a $1.4 billion shortfall in 2009. In fact, I have been told that if it were not for the large premiums that the FHA currently enjoys from the Home Equity Conversion Mortgages (HECM) program that the MMI fund could be running in the red right now.

So can you tell us what the principal factors are that are driving that MMI fund into the red in 2009?

Mr. MONTGOMERY. It would be the proliferation of the seller-funded down payment program.

Let me just quickly say, by the way, the Credit Reform Act requires us to put a book of business on budget every year. That is a good requirement. But our long-term financial solvency, our capital reserve is about $21 billion. But this year, again because of the ongoing proliferation of these loans, we are facing a shortfall, something that we have been telling Senate staff, House staff for some time now.

SELLER DOWN PAYMENT PROGRAM

Senator MURRAY. Let me go back to the seller down payment program. In the past, you have told us you support that. You now oppose it. Is that correct?

Mr. MONTGOMERY. Well, when you peel back the onion and when you look at what they do, you can easily see that they, at first blush, are doing good things, helping home ownership, but when you really dig deep—and you have to really dig deep into this—and look at some of the arcane actuarial performance claim rates and all that—I will not bore you with that. But point of fact is these loans have unacceptably high rates of claim and many of them are just destined to fail to begin with.

I have to say since that time, in the last 1½, 2 years, we have moved pretty aggressively to try to ban that sort of assistance, even going as far as a proposed rule that the courts did not rule in our favor. But we are coming back at it again.

Senator MURRAY. Mr. Kittle, do you have any comments on that program?

Mr. KITTLE. I do. I will say that when I bought my first home FHA, one thing that I do not want to be eliminated is the gift provision from a family member. My father—it required 10 percent down on the program that I chose back then, but my dad gave me 5 percent of the 10 percent. It was a gift. We went through the appropriate verifications. And I would like to see that left in place.

Senator BOND. We are talking about gifts from the sellers.

Mr. KITTLE. I understand.

Senator BOND. If daddy helps you with the down payment, if the roof starts to leak or the furnace goes out, you can go back to daddy.

Mr. KITTLE. Yes, sir.

Senator BOND. You cannot go back to the seller.

Mr. KITTLE. I just wanted to make the two distinctions that we are talking about. But as far as that, I agree with what Secretary Montgomery is saying.

Mr. MONTGOMERY. If I could just quickly add—I am sorry—we are not moving to outlaw that type of real gift assistance or from State housing finance agencies.

Senator MURRAY. Mr. Wade?

Mr. WADE. I was just going to chime in and say that there are many down payment closing assistance programs out there run by local jurisdictions, States. They perform quite well. And I think the challenge is when you do not have the arm's length distance between the persons and the transaction where there are problems.

HOUSING COUNSELING

Senator MURRAY. And, Mr. Wade, can I ask you? The housing counseling money—as you heard, Senator Bond and I added $180 million to the package that we are going to vote on shortly. Is there capacity out there for that money?

Mr. WADE. Absolutely. We had over $350 million worth of requests for a program that we rolled out that had a very short time frame and a targeted group of eligible applicants. So we know the demand is out there. We know that there are many other groups who were not able to participate in the program because of the short turnaround time and existing organizations who have received funding who applied for much more than we could award.

Senator MURRAY. Very good.

Senator Bond, I have been called back to the Energy and Water Committee. Because I trust you so much, I am going to turn over the gavel to you. I know we have a vote coming up shortly, and if you and Senator Allard want to ask your questions and adjourn the subcommittee.

And I would say again we have a number of questions. This is a critical topic. We will be submitting them to you and hope to get your replies fairly quickly. But thank you to all of you.

Senator BOND. Do you think you can straighten out Senator Dorgan on the Missouri River?

Senator MURRAY. Now, I am not going to take on Missouri's issues.

Senator BOND [presiding]. I said to the chair when she is up there she can put in a good word for the Missouri River because the chairman, I have just been advised, was attacking me when I was gone.

But I will ask a couple of questions and then turn it over to Senator Allard because I have another appointment as well.

An important thing, Mr. Montgomery, we are getting all these reforms, new opportunities. Do you have enough in the budget now to get the staff and the necessary resources? That is something this committee is very much concerned about because I believe the budget submissions were prepared long before anybody saw this coming and saw the role that the FHA would have to play. I would like to know if the budget submission before us actually takes into account this expanded role. Obviously, you cannot say you need more without getting fired, but did the budget submission come in time to factor in these new activities of FHA?

Mr. MONTGOMERY. I would say the only silver lining in the fact that it has taken 2 years to get FHA modernization, which we still do not have, is we have had a lot of time to plan for a victory party that may or may not come.

Now, having said that, the average age of our IT systems within housing is about 18 years, our oldest legacy system is 29 years. I often kid that we do hire Fortran and COBOL programmers.

So we will be ready with FHA reform and modernization. Do we need more funds for IT? Certainly and I am sure a lot of cabinet agencies would tell you the same thing.

ARM RESETS

Senator BOND. They often do.

I am going to ask one last question. With 1.4 million mortgages facing interest rate resets—and I hate the term "ARM resets." That is a little too personal for me.

But some 300,000 to 400,000 homeowners would face foreclosure. And this 25 percent foreclosure could climb as high as 40 percent. I would ask Mr. Kittle, Mr. Wade, and then Mr. Montgomery for a quick comment on what impact this would have on the housing market and on the overall economy. Mr. Kittle?

Mr. KITTLE. Fortunately right now, rates are down and they have fallen. A lot of these ARM's are tied to the LIBOR. The rates were attractive to some of the resets. Many of these ARM's have already refinanced, up to 50 percent of them. So the impact—excuse me—the loan reset. I am sorry about the ARM reset comment. So we hope and pray that the impact will be minimal going forward.

Senator BOND. Good.

Mr. Wade?

Mr. WADE. Sure. I would say one of the challenges we are concerned about is the increasing foreclosed properties that end up on the market, and they end up disproportionately being concentrated in certain communities. That has the tendency to create kind of a self-reinforcing downward spiral in those communities, further depressing prices and leading to additional distress and costs for local communities.

Senator BOND. That is one thing that Senator Isakson proposed and I included in the SAFE bill that I offered. I believe it is on the floor now, a 2-year tax credit, a total of $7,000 for families who will buy and move into a foreclosed home or a home facing foreclosure. I understand that the statements of the administration were very negative about that, but next to counseling, one of the most popular things I discussed with all of the housing people back in Missouri was getting people into those foreclosed homes.

Do you think this could have an impact?

Mr. WADE. Well, I think anything we can do to help get people back into these foreclosed properties—they end up being a drain on the community. They end up being havens for crime and drug activity. They end up costing local government hundreds of thousands of dollars of increased police protection. Oftentimes cities have to board the properties up successively. So I think clearly we have to address the REO challenge.

Senator BOND. I believe that is correct.

Mr. Montgomery, any comment on that?

Mr. MONTGOMERY. I agree with the comments of Mr. Kittle on the market, and I would say for our part with the FHA REO, we have asset control areas, other tools that we do to work with local governments to get homes rehabilitated and back on the market.

Senator BOND. Thank you very much.

I will turn this over to Senator Allard.

TEMPORARY OR PERMANENT PROGRAMS

Senator ALLARD [presiding]. Thank you, Senator Bond.

I have just a couple of quick questions. Then we will adjourn.

Should we think of our programs in terms of temporary or permanent? I am reminded of somebody who said if something should be temporary, how do we keep it that way. I think one of the sayings that floats around here is there is nothing more permanent than a temporary program, so I am kind of wondering what your thoughts are on a temporary program.

Mr. MONTGOMERY. Well, for FHASecure's part, even with these modifications, right now they would expire at the end of this calendar year. The proposals that we want to do through the risk-based pricing, though, would be permanent.

Senator ALLARD. I think the way our budget program and the way we analyze our spending through the Budget Committee—if you establish a spending program, the assumption by the Budget Committee frequently is that it continues on even though it expires. So it gives a great opportunity to keep adding onto that program, and I think that is what happens.

But how do we keep it temporary then?

Mr. MONTGOMERY. Well, these changes are being done administratively, which I do through what are called mortgagee letters, and the mortgagee letter states it will expire at the end of the year. Certainly looking at my crystal ball, we could reassess at that point whether or not we should continue it or not.

HOMEOWNER BENEFIT

Senator ALLARD. Now, let me move on to another subject quickly. In some of these proposals, there is sort of a profit sharing provision where you give special loan considerations with a home, for example, that has decreased in value. But then you establish that decreased value base, and then you go back 10–15 years later and it has increased. And there is a provision in there that then if you sell that home, then that sharing is divided between the agency and the homeowner. How do you enforce something like that?

Mr. MONTGOMERY. Well, we come at it from a little different way. I will say this. If someone uses FHA today on the purchase side and the home increases in value over 5 years, 10 years, certainly that is a benefit that the homeowner gets. We do not share in that. Obviously, with these improvements with FHASecure, it is a little different. But again, we are asking the lender to make a significant write-down in principal and perhaps put some of it in a second lien.

Going forward, may some benefit from that? Sure, but we look more globally that for the few that may profit, if you will, look at the long-term good by keeping people who really want to stay in their home avoid the ripple effect of foreclosure as a good thing.

Now, to keep them in their homes, the Dodd-Frank proposal proposes an exit premium, a cash reserve, if you will that if the borrower moves out the first year or second year, that you forfeit part of this. You pay what is called an exit fee. Right now we envision coming at that a little differently either with a resell restriction, you know, some recapture provision, again that a lot of State HFA's use, so that the person stays in the home. We do not think FHA should be holding funds in escrow over a borrower's head. At least again, this is how we envision going forward.

Senator ALLARD. Thank you for clarifying that.

ADDITIONAL SUBMITTED STATEMENT

The following statement from the National Association of REALTORS® was submitted for inclusion in the record.

[The statement follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

"THE FEDERAL HOUSING ADMINISTRATION'S ROLE IN ADDRESSING THE HOUSING CRISIS"

The mortgage crisis continues to grow—homeowners continue to face foreclosure, and housing markets are in turmoil. For all these reasons, I and the 1.3 million members of the National Association of REALTORS® thank you for holding this hearing on "The Federal Housing Administration's Role in Addressing the Housing Crisis".

In 1934 the Federal Housing Administration was established to provide consumers an alternative during a similar lending crisis. FHA served as the foundation for our housing market, which has served our citizens and our economy well for more than 70 years.

However, as private mortgage markets evolved, FHA remained stagnant. Because FHA was unable to serve its core constituency, other mortgage providers stepped in to fill the gap. Without another alternative, many homebuyers were lured into these more exotic mortgage options, which fueled our current crisis. Even after all of this evidence, the need for a viable FHA remains unmet. Despite the best efforts of you and others, FHA reform has yet to be achieved.

We urge you and your colleagues in the Senate to continue to work towards FHA reform. Permanent, realistic increases in the FHA loan limits; lowered FHA downpayment requirements; and new opportunities for condominium purchases are needed to create safe and affordable mortgage options for homebuyers and those wishing to refinance. These changes will also provide much needed stability to our local housing markets and economies.

We also believe that the FHASecure program has been, and can continue to be a valuable tool for homeowners in crisis. This program, introduced in September 2007, gives credit-worthy homeowners who were making timely mortgage payments but are now in default, a second chance with a FHA insured loan product. We believe enhancements to this program can help an even greater number of borrowers without negatively impacting the sovereignty of the FHA insurance fund.

As you know, through FHASecure, lenders and homeowners may refinance mortgages that, due to the increased mortgage payment following the interest rate reset have become delinquent. However, in many cases, subprime borrowers are becoming delinquent for reasons other than an interest rate reset meaning a rate reduction alone will not help borrowers avoid default or foreclosure.

Specifically, we believe that where prudent, FHA should modify underwriting criteria in return for a lower loan-to-value ratio thereby assuring the lenders share risk. Changes include:

—Permit late payments on fixed-rate and on conventional adjustable-rate mortgages without regard to interest rate reset or higher DTI ratios.
—Create a sliding scale whereby the number of late payments allowed for qualification is dependent on the LTV ratio. For example, LTV = 90 percent, with several late payments = 80 percent LTV.
—Permit second mortgage with CLTV treatment like FHASecure.

A borrower would only be permitted to utilize one of the program changes mentioned above for their mortgage. Loans that qualify for FHASecure under these changes could be placed into a special risk insurance fund to further protect FHA.

We submitted these recommendations to HUD on February 15 for their consideration. Based upon testimony given by the FHA Commissioner on April 9, 2008 before the House Financial Services Committee, we are hopeful that these changes will be implemented. The enhancements proposed will allow a greater number of borrowers to avoid foreclosure and reduce their burden of debt. Risk to FHA will continue to be mitigated by traditional FHA underwriting standards beyond the recommended enhancements to the FHASecure Program.

The National Association of REALTORS® thanks you for your efforts to help stem the housing crisis. Congress must act expeditiously to help our Nation's homeowners, communities, and local economies recover. We applaud you efforts and stand ready to work with you on solutions.

ADDITIONAL COMMITTEE QUESTIONS

Senator ALLARD. At this time, if any member has additional questions, please submit them for inclusion in the record.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. BRIAN D. MONTGOMERY

QUESTIONS SUBMITTED BY SENATOR PATTY MURRAY

FHASECURE

Question. The current FHA Secure program requires a borrower to have made all their mortgage payments for the 6 months prior to their interest rate resetting upward. Your new proposal to expand FHA Secure would allow borrowers that already missed some payments before their interest rate went up to participate in this program.

Can you tell us anything about the performance or the delinquency rate of the 150,000 loans that you have already taken in under your initial FHA Secure initiative?

Answer. While it is early to assess the performance of FHASecure loans, the loans endorsed in the period October 2007 to May 2008 have slightly lower ever-defaulted rates than purchase and FHA-to-FHA refinance loans. This is an early indicator that they are performing slightly better. Ever-defaulted rates are calculated as the number of loans that ever experienced a 90-day delinquency divided by the total number endorsed.

Question. Do you think that someone who has been delinquent on their mortgage payments before their interest rates went up represents an appropriate risk for the FHA? What protections do you have in your program to ensure that the FHA is not taking on greater defaults and claims under this initiative?

Answer. FHA expects that the borrowers refinancing under the FHASecure expansion will be similar to current and historical conventional-to-FHA refinance borrowers. Conventional-to-FHA borrowers generally perform better than FHA purchase borrowers, in part, because they have more experience making loan payments than FHA's typical first-time homebuyer and because they tend to have more equity in their property. By extending eligibility to borrowers who had two 30-day or one 60-day delinquency prior to reset, FHA expects no significant increase in risk because FHA borrowers include experience with short periods of default without going to claim. With regard to borrowers who have had more delinquencies and elect the 90 percent LTV option, FHA expects these borrowers to find their mortgages more affordable than they were in the past and clearly, FHA will have the additional 10 percent equity cushion to mitigate any losses. With a properly underwritten FHA loan, where capacity to repay has been carefully evaluated and documented, they should perform like typical FHA borrowers.

TROUBLED BORROWERS

Question. Under your proposal, troubled borrowers would be allowed to refinance their loan with an FHA loan at 90 percent of the current appraised value of the home. We also understand that the only role that FHA will play is in securing the loan. That is to say, that the borrower and the lender could establish a package containing a soft-second loan or another financial instrument allowing the lender to recapture the full cost of the original loan and any possible appreciation. What specific protections would FHA provide directly to these troubled borrowers?

Answer. FHA believes that it is more appropriate to allow lenders and borrowers to make their own arrangements regarding subordinate financing, which could include equity sharing. However, whatever terms are agreed to by the borrower and lender must not trigger a default on the FHA-insured first mortgage. Therefore, FHA has established the following conditions which we believe will protect the borrower as well as FHA:

—the terms of the subordinate financing must not provide for a balloon payment before 10 years unless the property is sold or refinanced;

—the terms must permit prepayment by the borrower without penalty, after giving 30 days advance notice;

—the required monthly payment under both the new FHA-insured mortgage and the subordinate liens plus other housing expenses and all recurring charges must not exceed the borrower's reasonable ability to pay; and

—any periodic payments due on the subordinate lien are due monthly and are essentially the same in dollar amount.

Question. Isn't there a danger that this type of structure could once again strap borrowers with unexpected debt at the time the house is sold or refinanced in the future?

Answer. As indicated previously, FHA has provided conditions under which subordinate financing can be offered, which protects the borrower from balloon payments and prepayment penalties while promoting affordability and the borrower's reasonable ability to repay on all their debts, not just the new mortgage. FHA has made it clear to its lender partners that FHASecure should not be used to delay the inevitable and that when subordinate financing is offered it should not trigger a default on the new FHA-insured mortgage.

DODD/FRANK PROPOSALS

Question. We understand that under the Dodd/Frank proposals, in exchange for the Government assistance to both the lenders/investors and borrowers, there would be a shared equity agreement. This was designed to eliminate any perceived bailout for the lender/investor and prevent the homeowner from receiving a windfall from the sale of a house with a reduced mortgage. This approach would also allow the Government to realize some benefit from taking on this additional risk. Does your proposal include any sort of shared equity arrangement?

Answer. FHA is an insurance company that relies solely on appropriately priced premiums and prudent underwriting in determining the level of risk it is willing to accept. FHA does not believe that it should be entitled to a sharing of equity since FHA did not provide any equity or write-down originally. FHA certainly does not object to those entities that actually wrote-down a portion of the outstanding indebtedness from attempting to capture a share of equity growth to prevent windfall profits, but FHA is providing only insurance coverage, not the actual write-down of the debt.

Question. Without this arrangement, how does your proposal avoid being a bailout or a windfall?

Answer. The entity providing the write-down, whether on the original first mortgage or on a second, or both, should be the ones that prevent a “windfall” being enjoyed by the borrower. FHA would permit existing lien holders to negotiate the terms of any write-down with the borrower, which could include the creation of new subordinate or modification of existing subordinate liens, either of which would be due upon sale of the property. Such an arrangement appropriately provides the lien holders with an opportunity to recover some amount and prevents any windfall to the borrower. FHA believes that it is only fair that the existing investors and note holders should be permitted to protect themselves by being entitled to a share of any net appreciation.

Question. Would you consider requiring a portion of the write down of the original loan to go to FHA to help offset the risk to the solvency of the FHA insurance fund?

Answer. No, FHA does not believe it should be entitled to the recovery of money it did not provide. FHA was not a party to the previous loan, sustained no losses from the principal write-down, and furthermore, has no infrastructure to implement an equity-sharing arrangement.

FHA UNDERWRITING

Question. Last year, we heard testimony from GAO and the HUD Inspector General that FHA doesn’t have sufficient standards or controls to manage risk and conduct rigorous underwriting. FHA’s share of the market at that time was 3 percent. Now FHA’s market share is approaching 9 percent, and that share would get even larger under your new proposals.

If you were struggling with these quality control issues last year when you were only serving 3 percent of the market, how can you adequately conduct the underwriting that you now must do at almost 9 percent of the market?

Answer. FHA’s claim and default rates are considerably below those in the subprime market because it does properly underwrite its mortgages and demands full documentation. But, FHA has stated that the agency needs more human resources, as well as additional funding for information technology, to better manage the increased volume of business and any changes that may result from enactment of reform legislation.

FHA STAFFING

Question. The 2008 Appropriations Act fully funded the President’s request for staffing within the FHA. But I’m still concerned over whether your agency has the support it needs to handle the additional workload it may be facing.

How have you been able to handle the expanded activity within the FHA? Is inadequate staffing proving to be an impediment to expanding activity at the FHA?

Answer. At the time that the fiscal year 2008 budget was sent to Congress, we were not aware of the full impact and extent that the national mortgage crisis would have on FHA. Single family applications have quadrupled since that time (first quarter of fiscal year 2007), increasing from approximately 55,000 per month to over 200,000 per month in April and May 2008. Despite this increase, we are using all the tools available to us, including making use of available technology, to handle this workload in as efficient a manner as possible. But, again, FHA needs additional human resources and additional funding for information technology to better manage the increased volume of business and any changes that may result from enactment of reform legislation.

Question. Are there any corners that you're cutting currently that you shouldn't be cutting due to inadequate staffing?

Answer. No, we are not cutting any corners. FHA has continued to operate using its normal procedures.

RISK-BASED PRICING

Question. In 2007, you indicated to the committee that you were going to establish a risk-based pricing system for all of FHA by the beginning of 2008. You didn't go ahead with that plan because there was legislation pending in Congress to prohibit it. Now, under your new initiative to expand the FHA Secure program, you intend to use risk-based pricing even though the Foreclosure Prevention bill that the Senate will pass in the next few hours prohibits its use. Why is risk-based pricing such an essential part of this new initiative?

Answer. FHA intends to implement risk-based premiums along with the expansion of FHASecure because the two initiatives together create a negative weighted average credit rate. Even with a 2.25 percent upfront premium and 0.55 percent annual premium, the delinquent FHASecure loans have a positive credit subsidy, but, with the implementation of risk-based premiums, these loans are cross-subsidized by other FHA borrowers; and consequently, the program can be implemented at no cost to the taxpayer.

Question. Will this initiative really involve varying rates for different borrowers or are all the new borrowers in the FHA Secure program likely to be charged the maximum rate because of their credit histories?

Answer. Under the expansion of FHASecure, all of the borrowers who are delinquent on their current mortgage will be charged an upfront premium of 2.25 percent; those who have loan-to-value ratios above 95 percent will pay annual premiums of 55 basis points. FHASecure borrowers who are not delinquent will pay risk-based premiums that vary with their credit scores and loan-to-value ratios. Many of these borrowers have lower loan-to-value ratios than the typical FHA purchase borrower and will consequently pay lower premiums than their credit scores alone might suggest.

Question. What will the impact be on the solvency of the FHA insurance fund if you are prohibited from establishing a risk-based pricing system?

Answer. The FHA insurance fund will continue to be solvent. Regrettably, FHA will be unable to implement the expansion of FHASecure as planned if it is unable to implement risk-based premiums. This is because the FHASecure expansion alone generates a positive credit subsidy rate. Without risk-based premiums for offset, FHA would need to establish an across-the-board premium that would generate an overall negative credit subsidy rate or receive an appropriation. Ironically, this would have the effect of raising premiums on lower risk purchase and refinance borrowers and lowering them on the higher risk delinquent FHASecure borrowers.

FHA FORECLOSURES

Question. As we all know, foreclosures can have a devastating impact on not just the families in the homes, but on entire communities. To date, the administration has only offered initiatives that address the individual homeowners.

What is HUD doing to help cities and communities that are taking on record numbers of abandoned homes, many of which are the direct result of lenders and investors walking away?

Answer. The Office of Housing is taking an important step in addressing the problem by working aggressively to reduce the number of loans that terminate in foreclosure. Use of FHA loss mitigation this fiscal year has increased significantly over 2007 levels. The vast majority of borrowers are being offered loan modifications that provide permanent changes in loan terms to make payments more affordable. With respect to Real Estate-Owned (REO) properties, housing only has jurisdiction over HUD-owned homes. HUD closely monitors its private sector contractors to ensure that HUD homes are clean, safe and sanitary, and that yards are professionally maintained to reflect neighborhood standards. In the hardest hit communities, HUD staff and contractors have established close working relationships with local governments, law enforcement and code enforcement officials. Additionally, HUD operated a number of special sales programs to sell properties at a discount to officers, teachers, firefighters and non-profit housing developers.

In addition, the Department's HOME and CDBG funds are being used by many cities to fund the purchase and rehabilitation of REO properties.

ASSET CONTROL AREA PROGRAM

Question. HUD currently has a program within FHA, the Asset Control Area Program, which gives you the authority to sell FHA foreclosed homes to non-profits and local governments at a significant discount. This program was designed to assist communities in designated areas eliminate blight and stabilize neighborhoods.

Are you using this authority to assist communities that have suffered as a direct result of this housing crisis?

Answer. HUD currently has 13 active Asset Control Area (ACA) partners and is working with other communities to determine if this program would be viable for them. HOC and HQ staff recently met with representatives from the city of Detroit and Wayne County, MI to discuss ACA and other discount programs and will continue this discussion. HUD is also setting up national training for potential ACA applicants. As indicated in our response to the previous question, other HUD programs, particularly the Community Development Block Grant (CDBG) program, are deeply involved in efforts to eliminate blight and stabilize neighborhoods.

FHA DOWNPAYMENT

Question. The administration's initial FHA reform legislation eliminated the downpayment requirement to allow HUD the flexibility to offer products better tailored to individual borrowers. Since that time, you have publicly stated that some downpayment is necessary and a requirement of as much as one percent may be needed. The recently passed Foreclosure Prevention Act of 2008 requires a 3.5 percent downpayment. Where is the administration now on the appropriate downpayment requirement for FHA?

Answer. FHA's original proposal for a zero downpayment product was intended to offer a safer, less-expensive alternative to seller-funded downpayment assistance which, in reality, is paid for by the homebuyer in an inflated sales price, as well as to provide an affordable alternative to the subprime products previously available. Although the administration has agreed to compromise on a minimal cash investment of 3 percent or less, the rationale for a 100 percent financing product remains. As demonstrated by the Veterans Administration and Rural Development programs, a 100 percent financing product that is offered in conjunction with appropriate underwriting standards can perform very well and certainly benefits first-time homebuyers who lack the cash for a downpayment.

Question. What is the current trend with downpayment requirements for conventional loans and what do you anticipate in the future?

Answer. There are still a number of no-downpayment programs available, some through portfolio lenders, others through the GSEs (in addition to those offered with VA or RD guarantees). Unfortunately, the conventional products are only available to borrowers with exceptionally good credit bureau scores who can also meet other stringent underwriting criteria. While the immediate trend in the industry, in the midst of the market contraction, is to require higher down payments, it is highly likely that there will be a movement back towards the higher loan-to-value loans in the future, provided there is appropriate underwriting.

Question. If the FHA is frozen with a mandatory 3.5 percent downpayment requirement, and the markets change again requiring less downpayment with more focus on credit scores and repayment ability, would FHA once again be unable to adapt to changing markets?

Answer. Yes, FHA would be unable to keep pace with product changes in the marketplace. FHA has learned, as have the GSEs and others, that the downpayment is but one element in determining the risk on a loan. FHA asked for the flexibility to offer a range of downpayment options, and to use what it has learned about credit and application variables in developing its TOTAL mortgage scorecard to determine if a borrower is a likely candidate to repay the mortgage based on income rather than future house price appreciation.

PRIVATE MARKET DOWN PAYMENTS

Question. The private market has responded to the housing crisis and many are now increasing downpayment requirements. How will this impact homeownership opportunities for low and moderate income Americans?

Answer. We know that the most significant burden to homeownership is acquiring the cash for the downpayment, and anything that demands an even greater downpayment—despite sales prices falling throughout most of the country—will negatively affect homeownership opportunities.

FHA LOAN LIMITS

Question. A temporary increase in the FHA loan limit was included as part of the economic stimulus package passed by Congress in February. I supported that increase so that FHA would be able to serve high cost areas. The testimony that Commissioner Montgomery has offered today states that FHA anticipates being able to refinance 100,000 new loans for troubled borrowers in high cost areas as a direct result of this increased loan limit. However, the Foreclosure Prevention Act that passed the Senate yesterday reduces the loan limit from the level included in the Stimulus package. Can you comment on the response that you have seen from the lending community to the higher loans limits that were in the Stimulus package?

Answer. The lending community, as you might guess, was quite delighted to see the new loan limits, especially the rise in the floor for FHA to $271,050. While the $729,750 loan limit does provide some possible relief in high-cost areas, mostly along the two coasts, those limits affect only about 75 counties total. All in all, FHA can still be a major stabilizing force in the housing market even with the lower loan limits proposed in the Senate's Foreclosure Prevention Act.

Question. Will lenders that have come into the fold as a direct result to these higher limits walk away if they are reduced, and what will be the impact in high cost areas?

Answer. It is never a good thing in the marketplace to have a product offering more responsive higher loan limits taken away. The uncertainty of the availability of high mortgage limits will likely result in many lenders stop making such loans several months before the loan limits expire.

MMI FUND

Question. HUD's budget assumes that there will be three major reforms to the FHA single-family housing program. I am told that, if these reforms are not enacted this year, the Mutual Mortgage Insurance (MMI) fund could potentially face a $1.4 billion shortfall in 2009. In fact, I am told that if it weren't for the large premiums that the FHA currently enjoys from the popular Home Equity Conversion Mortgage—or "heck-um"—program, the MMI fund would be running in the red right now. What are the principal factors that are driving the MMI fund into the red in 2009?

Answer. Currently, HECM loan guarantee transactions are financed in the General Insurance Fund of FHA, not MMI, and have no effect on the financial position of the latter Fund. There are two principal reasons for the potential adverse subsidy rate for the MMI Fund. First, the continued and large proportion of seller-financed downpayment assistance loans have a much higher claim rate than other loans. The second factor is the general distress in the housing market that is reversing appreciation in house prices and making it more difficult for our borrowers to sell or refinance their homes and pay-off the full outstanding indebtedness, thereby increasing the claim rate. The decline in house prices has also made the net loss on claims larger since FHA recovers less on the sale of the foreclosed asset.

SELLER DOWNPAYMENT PROGRAM

Question. In the past, you have supported the continuation of the seller downpayment program. You now want to shut it down. Why do you now oppose the program?

Answer. Although HUD describes the reasons for its actions in detail in the Federal Register notice (73 Fed. Reg. 33,941 (June 16, 2008)), in summary, HUD has always had concerns about the loans coming to FHA with seller-funded downpayment assistance. As early as 1999, HUD issued a proposed rule that would prohibit the practice of charitable organizations creating downpayment assistance from "donations" given by property sellers that have a direct interest in the property sale transaction. Due to comments received on that proposed rule, and the lack of sufficient long-term loan-performance data, HUD withdrew the rule. Instead, HUD then began to monitor this subportfolio more closely. Since 1999, many things have changed. First, this type of downpayment assistance has grown from under 2 percent of purchase endorsements in 1999 to over 35 percent in 2007 and 2008. Second, the credit risk of these loans has proved to be well outside the bounds of what is prudent and what can be supported by FHA insurance premiums. Third, in both 2004 and 2005, HUD supported legislative initiatives designed to give FHA the authority to insure zero-downpayment loans, which would provide a safer alternative to wealth-constrained households. Zero-downpayment would be safer because the home buyer would have the ability to negotiate with any seller, and not just those willing to work with a downpayment provider. There also would be no pressure for the seller to demand a higher price from this buyer than from other buyers, to cover the cost of the downpayment assistance. Finally, in November 2005 the GAO issued a research report to the Congress that explicitly stated that the risk of these loans is such that they should be banned from the FHA insurance program. In response to that GAO report, HUD pointed to FHA's pursuit of a zero-downpayment insurance product and higher insurance premiums as better alternatives to achieve those goals than banning seller-funded downpayment assistance would be. Because of the growing financial problems associated with seller-funded downpayment assistance and because the legislative initiatives never materialized, HUD determined that the most prudent option was, and remains, to prohibit seller-funded downpayment assistance. In addition, this new rule brings HUD in line with GAO and IRS, who after analyzing the structure and effects of the seller-funded downpayment assistance practice have determined, in the case of GAO, that the practice is detrimental to FHA and the homebuyers it serves and should be prohibited, and in the case of IRS, that it involves no charitable gift.

Banning seller-funded downpayment assistance will restore the financial soundness of the FHA insurance funds. FHA is currently in a position of losing money on new single-family insurance endorsements, principally because of seller-funded downpayment-assisted loans. Such loans have default and claim rates that are two to three times higher than those for other loans. Under the current statutory scheme, FHA cannot charge high enough premiums to pay for such high rates of foreclosure. Indeed, having such high foreclosure rates is a disservice to the households who purchase homes with FHA insurance, and it is potentially destabilizing to neighborhoods.

CONTRACT FUNDING

Question. The President's budget request does include a significant increase over the fiscal year 2008 level, but according to HUD officials this level of funding would still leave the account short by approximately $2.4 billion. Short-funding these contracts has been an issue since HUD came under this subcommittee's jurisdiction. Now, these funding needs have been pushed to the breaking point and it appears that your budget would just dump this massive funding problem onto the next President. What is the total cost to renew all expiring contracts for a full 12 month term when they expire?

Answer. The President's fiscal year 2009 budget request ($6.763 billion) for section 8 project-based contract renewals will allow HUD to fund all contracts into the first quarter of fiscal year 2010, thus ensuring continuity of payments until fiscal year 2010 appropriations are in place.

For fiscal year 2009, we estimate that a total of $8.4 billion is needed to fully forward-fund all renewal contracts for a period of 12 months. Additionally, approximately $700 million would be required to amend existing long-term contracts for the same period, bringing the grand total to about $9.1 billion.

Question. Your budget documents state that your request will only be sufficient to fund contracts "into the first part of fiscal year 2010." Don't you believe the uncertainty with owners—not receiving payments for months at time, having to dip into their reserves to make mortgage or utility payments—has disrupted the good faith of the Government with the private sector for this program?

Answer. The Department has expressed its regret over the disruption in payments that occurred in fiscal year 2007, and has modified its standard renewal contract language, thus addressing the legal issues that caused the problem. The practice of partially funding section 8 contracts was begun more than a decade ago, and we believe that owners and investors have adapted to that practice. While funding contracts for a full 12 months would reduce administrative workload, it would also require large increases in Budget Authority in fiscal year 2009.

Question. Do you believe as a result of these activities owners will begin to leave the program thus displacing tenants and if so what are you doing to rectify this problem?

Answer. A recent study by the GAO found that opt-outs are primarily determined by market factors such as demand for condominium conversions or luxury rentals, rather than by dissatisfaction with HUD. While HUD regrets the disruptions that occurred last year, and is doing everything possible to avoid a recurrence of the problem, we are currently experiencing very few opt-outs, and do not expect to see many in the future given the present real estate market.

QUESTIONS SUBMITTED BY SENATOR DIANNE FEINSTEIN

FHA LOANS

Question. Assistant Secretary Montgomery, in California, the number of FHA loans is expected to grow by as much as 90,000 under the new temporary increased loan limit of $729,500. This is a huge increase from the 6,000 loans FHA made in 2006. What steps is FHA taking to handle the expected increased loan volume in States like California and ensure that these loans are processed as quickly as possible?

Answer. Initial processing of loans is performed by the mortgage lender with the lender responsible for originating, underwriting, and closing the mortgage. Since the advent of FHA's Lender Insurance program, which permits high-performing lenders to self-insure, nearly 75 percent of mortgages are insured without the need for FHA to review the loan prior to granting the insurance. For the other 25 percent of business that is submitted to FHA's Homeownership Centers for insuring, the agency has contractors in place to handle the reviews. Therefore, while FHA does need additional human resources in general to support the increase in business nationwide, the agency will be able to handle the increased loan volume from California.

NATIONAL LICENSING STANDARDS

Question. It is imperative that loan products are offered by well-trained, ethical, and licensed professionals. According to the FBI, mortgage-related fraud reports in California have increased ten-fold over the last 5 years—from 1,143 in 2002 to 12,472 in 2007. Unscrupulous brokers and lenders, combined with weak underwriting standards, have played a major contributing role in the housing crisis. Do you support efforts to establish minimum national licensing standards, to be enforced at the State level, for all mortgage brokers and lenders?

Answer. It is important that mortgage brokers and lenders are regulated and held to certain standards to ensure they are responsible and worthy of the public trust. Purchasing a home is an important financial and emotional commitment, and consumers rely on mortgage professionals for knowledgeable and sound guidance. It should be noted that because of our gate-keeping and safe guards, FHA's programs have not been subject to the widespread fraud that has plagued the conventional marketplace. FHA approves and annually recertifies all mortgage brokers and lenders participating in its programs, and our underwriting standards have remained rigorous. Minimum national licensing standards, to be enforced at the State level, for all mortgage brokers and lenders, is a major proposal and hence, deserves a full national discussion by all interested parties. The Department would then address the issues that derive from such a full policy debate.

FHASECURE

Question. The FHA Secure program, created in August 2007, was designed to help homeowners facing significant increases in their mortgage payments to refinance into a Government-insured, fixed-rate loan. Specifically, homeowners who have some equity in their homes and have kept up with their mortgage payments. Reports indicate that so far fewer than 2,500 borrowers have been helped to date, much lower than the 240,000 first projected. Furthermore, the President's new plan to expand the FHA Secure program is estimated to help 100,000 more homeowners. What measures will be taken to ensure that the new expansion of the FHA Secure program will help more struggling homeowners?

Answer. As of June 15, 2008, FHA has helped over 239,000 families refinance into a safer and more affordable FHA-insured loan, pumping over $36 billion of much-needed mortgage activity into the housing market through FHASecure, as well as exceeding our initial projections of 240,000 for all of fiscal year 2008. More than 90 percent of FHA-backed loans are 30-year fixed rate mortgages and homeowners using FHASecure are saving $400 a month on average compared to their previous subprime loans. By expanding this initiative, FHA is poised to insure even more mortgages, now including those for borrowers who were late on a few payments in the previous 12 months and/or received a voluntary mortgage principal write-down from their lender. With these new eligibility criteria, the expanded FHASecure initiative can help additional homeowners access a more viable refinancing option and will offer lenders an alternative to foreclosing on these individuals. Along with principal writedowns, FHA will also encourage lenders to make other arrangements, such as subordinate financing, to "fill the gap" between the existing loan balances and the FHA-insurable loan amount. With the expansion of FHASecure we now expect to help 500,000 families by the end of the year.

CONCLUSION OF HEARING

Senator ALLARD. The subcommittee stands in recess until Thursday, April 17, when we will take testimony on the FAA's efforts to ensure aviation safety.

I thank the panel for their testimony.

[Whereupon, at 11:06 a.m., Thursday, April 10, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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