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H.R. 3043, THE ZERO DOWNPAYMENT PILOT PROGRAM ACT OF 2005

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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H.R. 3043, THE ZERO DOWNPAYMENT PILOT PROGRAM ACT OF 2005

Thursday, June 30, 2005

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

The subcommittee met, pursuant to notice, at 10:07 a.m., in Room 2128, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Tiberi, Pearce, Neugebauer, Waters, Davis of Alabama, Cleaver, and Green.

Chairman NEY. We will begin. I assume some other members will be arriving.

This morning, the subcommittee meets to discuss Congressmen Pat Tiberi's and David Scott's legislation to create more homeownership opportunities for first-time homebuyers. Reintroduced last week, H.R. 3043 would eliminate the downpayment requirement for families and individuals who buy homes with FHA-insured mortgages. Of course, we took this bill up last time and moved it out of the committee.

Theoretically, downpayment requirements were established to assure the lender that a borrower would be less likely to default or risk foreclosure on a home if there was some personal investment or stake. Through the invention of automated or computerized underwriting to determine credit scores, lenders believe that downpayments were one of the best techniques for the credit-worthiness of a potential borrower.

At the hearings conducted on March 24, 2004, and the full committee markup on June 3, 2004, on the previous bill, H.R. 3043 incorporated the 2004 reported bill as well as some key revisions that will establish the bill as a pilot program, and limit the pilot to 50,000 loans, and sunset the program in 2010. Today's hearing will allow us to continue our discussions from the previous Congress as to whether this proposal would increase defaults and foreclosures for FHA-related mortgages, placing the Government at a higher liability.

The new legislation incorporates several safeguards to protect FHA's mutual mortgage insurance and that fund would of course enhance provisions developed during last year's markup. These changes, I think, will help the pilot program to be responsive to concerns that without adequate safeguards, zero downpayment re-

quirements will lead to increased foreclosures, so I think that will help with the argument that it will not.

However, critics will continue to state that it is unclear whether removing downpayment requirements could be a sound underwriting decision or whether borrowers without downpayment contributions from their own resources would pose a greater credit risk. As we debate Congressman Tiberi's and Congressman Scott's zero downpayment proposal, as we debated it last year, we know that the biggest obstacle to homeownership for most families is the inability to come up with enough cash to meet downpayment and closing costs. Minority families in particular are burdened by high downpayment requirements.

In the first quarter of 2005, the racial divide in homeownership remains wide, with 76 percent of white households owning their own home, compared with 48.8 percent of African-American households and 49.7 percent of Hispanic households. Lagging minority homeownership rates are a serious concern. Minority households are expected to account for two-thirds of the household growth over the coming decade. As we continue our debate on legislation such as zero downpayment and other homeownership initiatives, clearly the ability of such households to make transitions to homeownership will be especially important, and an important test of the Nation's capacity to create economic opportunities for minorities and immigrants and for all Americans.

This is an important piece of legislation. I have talked to Mr. Tiberi and Mr. Scott. I hope people fully realize that a lot of people are out there and they will struggle to make that payment. They will do everything they can do, but sometimes they have to save so long for the downpayment that they could have had their children and their families into housing a long time ago.

So I think this bill is a very, very reasonable balance, with safeguards, more of them than the last piece of legislation, so I look forward to working with the committee on it.

With that, are there any other opening statements?

I ask unanimous consent to insert written testimony for the record for the National Model Housing Council and the Department of Housing and Urban Development.

I want to welcome our panel today.

We have Ms. Janis Bowdler. She is a housing policy analyst with the National Council of La Raza. The Council was established in 1968 and is a nonprofit organization established to reduce poverty, reduce discrimination, and improve opportunities for Hispanic Americans.

Robert Newman is the executive vice president and chief operating officer of AmeriDream, Incorporated, a nonprofit organization founded in 1999 to expand affordable housing opportunities for underserved groups. AmeriDream seeks to improve and promote the value of homeownership as the foundation of building strong communities and individual prosperity.

Michael Petrie is the president of P/R Mortgage & Investment Corporation in Indianapolis, Indiana, and chairman of Greensfork Township State Bank in Spartanburg, Indiana. Mr. Petrie is the current chairman of the Mortgage Bankers Association.

Mr. William B. Shear is Director of Financial Markets and Community Investment at the United States Government Accountability Office, GAO. Mr. Shear's work has focused on Government-sponsored entities, the Federal Housing Administration and the Rural Housing Service and community and economic development programs. He is no stranger to the committee, I would note.

Dave Wilson is a custom homebuilder from Ketchum, Idaho. He serves on the board of the Idaho Housing Finance Agency and is testifying today as the 2005 president of the National Association of Home Builders. The Association's mission is to enhance the climate for housing and the business industry.

With that, I am going to go just a little bit out of order. I want to thank all the panelists, and we start with Mr. Shear.

STATEMENT OF WILLIAM SHEAR, DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SHEAR. Mr. Chairman, members of the committee, I am pleased to be here this morning to discuss methods the FHA can use to manage risk in the new zero downpayment product.

My testimony is primarily based on our recent report on actions needed to help FHA manage risk from new mortgage loan programs. We reviewed a substantial amount of research indicating that loan-to-value ratio, called LTV, and credit score are among the most important factors when estimating the risk level associated with individual mortgages. Our analysis of the performance of low and no downpayment mortgages supported by FHA and others corroborates key findings in the literature.

Generally, mortgages with higher LTV ratios and lower credit scores are riskier than mortgages with lower LTV ratios and higher credit scores. In our report, we suggested that Congress may want to consider limiting any new zero downpayment product that it may authorize. We also recommended that HUD, among other things, consider piloting new products such as a zero downpayment product and that HUD establish a framework for when and how to pilot programs. We also recommended other actions HUD could take to mitigate the risk of new and changed products that are discussed in my written testimony.

In this oral summary, I will focus on our suggestions and recommendations pertaining to piloting a zero downpayment product. In summary, there are several risk-management practices mortgage institutions use in designing, implementing and monitoring low and zero downpayment products. We believe these practices could be instructive for FHA in managing risks associated with the zero downpayment product.

Therefore, if Congress decides to authorize the zero downpayment FHA product, we support piloting the product and piloting is a major feature of H.R. 3043. Based on information we obtained from selected conventional mortgage providers, private mortgage insurers, and Fannie Mae and Freddie Mac, mortgage institutions sometimes use pilots to limit the initial availability of new products, to build experience, or to better understand the factors that contribute to risk for low and no downpayment products.

Some mortgage institutions also may limit the origination and servicing of the product to their better lenders and servicers. HUD officials told us that they face challenges in administering the pilot program in limiting mortgage products to certain approved lenders or servicers. However, there are several available techniques for limiting an initial product that could help to address HUD's concerns, including limiting the time period in which it is available.

Further, we believe that in some circumstances the potential cost of making widely available a product when the risks of that product are not well understood could exceed the costs of initially implementing such a product on a limited basis.

I will provide some examples of how some mortgage institutions limit availability of new products. Fannie Mae and Freddie Mac sometimes use pilots for limited offerings of new products to build experience with a new product type or to learn about particular variables that can help them better understand the factors that contribute to risks for these products.

Freddie Mac and Fannie Mae officials also told us they sometimes set volume limits for the percentage of their business that could be low and no downpayment lending. Fannie Mae and Freddie Mac officials provided numerous examples of products that they now offer as standard products, but which began as part of underwriting experiments. These include the Fannie Mae Flexible 97 product, as well as the Freddie Mac 100 LTV product.

FHA has also utilized pilots or demonstrations as well when making changes to its single-family mortgage insurance. Generally, HUD has done this in response to legislation that requires a pilot and not on its own initiative. For example, FHA's home equity conversion mortgage insurance program started as a pilot. Congress initiated the program, which is sometimes called a reverse mortgage, in 1987 to provide elderly homeowners the financial vehicle to tap the equity in their homes without selling or moving from their homes.

Through statute, the program started as a demonstration program that authorized FHA to insure 2,500 reverse mortgages. Through subsequent legislation, FHA was authorized to insure an increasing number of these mortgages until Congress made the program permanent in 1998.

In summary, loans with low or zero downpayments carry greater risk. Without any compensating measures such as credit enhancements and increased risk monitoring and oversight of lenders, introducing a new FHA zero downpayment product would expose FHA to greater credit risk. We believe that FHA could mitigate the risk and potential costs of a zero downpayment program by conducting the program as a pilot. Because it may take a few years to determine the risk of a new loan product, even early termination of a fully implemented product could still expose the government to significant financial risk, without some types of limits on the number of loans insured.

Mr. Chairman, it is always a great privilege to be here. It is wonderful to be here. I would be happy to answer any questions.

[The prepared statement of Mr. Shear can be found on page 62 of the appendix.]

Chairman NEY. Thank you very much.

Ms. Bowdler.

STATEMENT OF JANIS BOWDLER, HOUSING POLICY ANALYST, NATIONAL COUNCIL OF LA RAZA

Ms. BOWDLER. Thank you, Chairman Ney, Ranking Member Waters, and members of the committee for inviting me to speak today.

I am Janis Bowdler from the National Council of La Raza. I feel honored to be before this committee as part of such a distinguished panel. Though I clearly do not have as many years of experience as others here today, I do bring with me NCLR's expertise and perspective on this important issue.

As NCLR's housing policy analyst, I conduct research, policy analysis, and advocacy. I have published on fair and affordable lending, housing counseling, and access to homeownership. I also provide technical assistance to NCLR grantees that operate housing counseling programs. NCLR is the largest Hispanic constituency-based civil rights organization in the Nation. We serve America's 40 million Hispanics in all regions of the country through a network of more than 300 nonprofit affiliate organizations.

Today, I want to briefly talk about the importance of increasing homeownership and building wealth in Latino communities, offer NCLR's perspective on the Zero Downpayment Act, and finally I will make a few recommendations to further strengthen the bill.

Increasing Latino homeownership is critical to the financial security of Latino families and the economic stability of the broader community. In this spirit, NCLR has been a leader in promoting and increasing Hispanic families' access to fair and affordable homeownership for more than 20 years. Recently, we have begun focusing our efforts on helping Latino families accumulate assets and build wealth for the future. In 1997, we created the NCLR homeownership network to provide homeownership counseling to Latino neighborhoods through community organizations. Since then, more than 115,000 families have been counseled through our network. More than 17,000 of these families have become homeowners.

The Latino population continues to grow at rapid rates. While the number of Latinos entering the homebuying market continues to grow, Latino homeownership still lags behind that of whites by 28 percentage points. Such low homeownership rates translate into lower levels of wealth and fewer financial opportunities in the form of tax benefits and home equity. For this reason, Hispanic wealth is outpaced by that of whites by 27 to 1. As you all are well aware, wealth accumulated through home equity is essential for sending children to college, starting small businesses, or providing for a family during retirement. This is especially true among low-and moderate-income families.

While Hispanics face a number of barriers to homeownership, affordability and lack of affordable mortgage products are two key barriers. The zero downpayment pilot program addresses both barriers. FHA has been a mainstay of affordable mortgages for underserved populations for decades. This includes Latino families as well. One in five Hispanic mortgageholders in 2004 had an FHA-insured mortgage.

However, FHA has also been plagued by high foreclosure rates and lender and broker abuse. In 2004, the rate at which FHA began foreclosures on their loans was more than 5 times that of prime lenders. Foreclosures are devastating to these families. FHA foreclosures, in particular, pose significant costs to American taxpayers. As you consider this pilot program, keep in mind the financial risk and potential for abuse that it poses.

However, the addition of default counseling is a significant improvement over earlier versions of the legislation. Housing counseling is a powerful tool that connects low- and moderate-income families with their first homes. For example, in 2004, 90 percent of NCLR homeownership network clients earned below 80 percent of the earned median income. Of those who became homeowners, the average interest rate was only 6 percent. Even more importantly, when homeownership counseling is received before the time of purchase, it significantly reduces the likelihood of 60-day delinquency.

NCLR commends Congressman Tiberi and Congressman Scott and the members of the committee for their diligent efforts on affordable housing and housing counseling. That said, we do have some ideas as to how the bill can be further strengthened. NCLR makes the following three recommendations.

First, ensure adequate resources for housing counseling agencies. This can be done by clarifying that counseling agencies can be compensated by lenders based on the value of their service. Consistent income based on the delivery of service will allow counseling agencies to build capacity and expand their operations. This is important, given the number of families that will need counseling services because of the zero downpayment pilot.

Second, ensure timely access to counseling, specifying that counseling must be completed before the application is even taken. It is critical that families are given an opportunity to make fully informed decisions prior to beginning the loan process.

Finally, prevent unethical lending practices by allowing the products to be offered only by FHA-approved lenders who perform well in HUD's Credit Watch program. I would like to stress that fair, affordable, and flexible mortgage products are important to increasing wealth through homeownership. The zero downpayment product offers families a flexible mortgage option and the addition of housing counseling will help vulnerable families to decide if this product meets their needs.

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

[The prepared statement of Ms. Bowdler can be found on page 40 of the appendix.]

Chairman NEY. Thank you very much.

Mr. Newman.

STATEMENT OF ROBERT NEWMAN, EXECUTIVE VICE PRESIDENT, AMERIDREAM, INC.

Mr. NEWMAN. Good morning, Chairman Ney, Ranking Member Waters, and distinguished members of the subcommittee. Thank you for the opportunity to testify regarding H.R. 3043, the Zero Downpayment Pilot Program Act of 2005.

My name is Robert Newman. I am the executive vice president and chief operating officer of AmeriDream, Inc. The work of AmeriDream began in February of 1999 to help reduce the government's burden of increasing homeownership to everyone. Since our inception, we have helped more than 160,000 low- to moderate-income individuals and families become homeowners and have given more than $500 million in downpayment gifts to homebuyers nationwide.

We have provided homebuyer education to over 6,000 people; counseled over 500 homeowners seeking help with loss mitigation; invested over $12 million in community redevelopment projects; and given over $2 million in funding to other nonprofits to support their missions. All our services are provided in both English and Spanish. It is important to know that all these services have been provided free of charge to homebuyers and have not used government funding or taxpayer dollars.

Last year, Ann Ashburn, AmeriDream's president and CEO, testified and provided testimony to this subcommittee and suggested refinements to the Zero Downpayment Act. We commend the subcommittee for listening to the input of everyone who was here. It is only appropriate that I acknowledge some of those improvements.

First, we are pleased that homebuyer education is now a requirement for homebuyers participating in the zero-down program. Second, we are grateful for the required disclosures regarding the homebuyers' alternatives to the zero-down program, as well as disclosing any increased costs associated with the use of the program. Third, H.R. 3043 is improved by the use of HUD's total scoring systems in the processing and approving of applications. And fourth, by implementing the zero-down program as a pilot program, it advances the important policy objective in a way that reduces the potential risk and enhances the program's likelihood of success.

In that same spirit of providing ongoing input for the subcommittee, we would respectfully propose three additional refinements for the bill. First, we encourage the subcommittee to seek appropriate ways to leverage the substantial experience and resources of charitable downpayment gift providers. We believe this can be accomplished by recognizing in H.R. 3043 that nonprofit downpayment assistance providers are structured to reduce the burdens on government's limited resources and are viable options to the zero-down program for homebuyers who do need downpayment assistance, but choose not to use the zero-down program.

Second, we suggest that H.R. 3043 ensure homebuyers the option of using nonprofit downpayment assistance program to offset any fees associated with participating in the zero-down program.

AmeriDream has created a place called "home" for more than 160,000 individuals and families. In fact, from the time we sat before you last year to now, AmeriDream alone has helped an additional 30,000 homebuyers become homeowners. We respectfully suggest that the members not overlook the integral role that nonprofit organizations such as AmeriDream can continue to play in helping low- to moderate-income homebuyers achieve the dream of homeownership.

Third, we recommend that homebuyers using the zero-down program have a 700 credit score. The amount of equity that a family has in its home has been shown to be one of the principal drivers of mortgage default. Most 100 percent no downpayment programs in the conventional market require that the borrower have a relatively strong credit score. A score of 700 will be consistent with the market and will coincide with FHA's goals of fostering successful homeownership.

The refinements we propose are intended to enhance H.R. 3043's ability to increase successful homeownership. They are offered in the spirit of partnership and are supported by the experience and accomplishment of having successfully enabled more than 160,000 families in this country to attain the American dream of homeownership.

Mr. Chairman, I hope my comments and suggestions make clear to you and your distinguished colleagues that we praise your efforts in fostering homeownership for the low- to moderate-income families of America. We also hope that under your leadership and direction, our suggested refinements will be included in H.R. 3043 as you consider what is best for those among us who heretofore have had the greatest challenges in gaining successful homeownership.

Thank you for your time, and I welcome any questions you may have for me.

[The prepared statement of Mr. Newman can be found on page 49 of the appendix.]

Chairman NEY. Thank you for your testimony.

Mr. Petrie.

STATEMENT OF MICHAEL PETRIE, PRESIDENT, P/R MORTGAGE & INVESTMENT CORPORATION, TESTIFYING AS CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Mr. PETRIE. Good morning, Chairman Ney, members of the committee. Thank you for inviting the Mortgage Bankers Association to share its views on H.R. 3043, the Zero Downpayment Pilot Program Act of 2005. We applaud Congressman Tiberi and Congressman Scott for recently introducing the bill.

My name is Michael Petrie and I am president of P/R Mortgage, an investment corporation in Indianapolis, Indiana; chairman of Greensfork Township State Bank, Spartanburg, Indiana; and chairman of the Mortgage Bankers Association.

MBA believes FHA should have the ability to offer a no downpayment home loan product to extend the opportunity of homeownership to more American families. As this committee is well aware, homeownership is one of the most significant aspects of the typical family's financial health. While the FHA began this success story for the American family over 70 years ago, the private sector has continued with innovations, especially over the past 15 years in developing sophisticated credit qualifying tools and a diverse array of mortgage products.

Over a year ago, MBA testified before this subcommittee in support of an FHA zero downpayment product. While we celebrate the U.S.'s high homeownership rate, the very same rate masks a glaring disparity. Minorities have a much lower rate of homeownership

than non-minorities, and low- and moderate-income families have a much lower rate of homeownership than most at or above median-income levels. This was true a year ago and unfortunately remains true today.

The downpayment hurdle disproportionately affects low- and moderate-income families who may be able to make monthly housing payments without difficulty, but find it problematic to save for the downpayment. Members have discovered, and the studies support, that a borrower's credit profile is a more important indicator of the performance of a loan than is the amount of the downpayment. The national credit information system preserved under the Fair and Accurate Credit Transactions Act of 2003, allows lenders to efficiently access a borrower's credit information and effectively evaluate risk.

So in looking to remove the downpayment as an obstacle to homeownership, MBA is not suggesting a homeownership at all costs strategy. Rather, we are advocating a targeted and measured attempt to remove the downpayment obstacle and close the homeownership gap among ethnic groups and economic classes.

However, we understand the real estate finance system must be careful and appropriate when lending money to families for often the largest investments they will make. Recently, some have expressed concern that lenders are extending too much credit and these loans may pose a risk. All the more reason for a strong FHA, an FHA that is empowered to pilot products, and specifically a no downpayment mortgage financing product for homebuyers with required counseling and with all the protections that go along with FHA insurance. FHA's loss mitigation program will ensure these borrowers have many options at their disposal after the loan closes if they run into difficulty.

With these safeguards, MBA is confident the FHA zero downpayment product will allow good borrowers to become good homeowners. When the bill was introduced last year, some in Congress and in the industry were critical of the Zero Downpayment Act of 2004. However, most of the concerns were addressed by the Financial Services Committee when the bill was marked up in the 109th Congress. H.R. 3043 also addresses those concerns. Over the past year, some developments have occurred to make an FHA zero downpayment program even more relevant today. There was concern last year regarding FHA delinquencies and foreclosures. There is good news to report. FHA delinquencies and foreclosures have declined during the first quarter of 2005 according to MBA's most recent national delinquency survey.

Finally, last year the cost of the program to the Federal treasury caused some apprehension. Recently, however, the Congressional Budget Office lowered the program's financial score over 5 years. It is important to remember that FHA generates hundreds of millions of dollars through insurance premiums. MBA does have suggestions for minor improvements to H.R. 3043 that we believe would further strengthen the program.

First, MBA would suggest allowing classroom or group counseling. This counseling resembles the type used by Fannie Mae and Freddie Mac for meeting the mandatory counseling requirements under their programs. Second, the statute should explicitly state

that generic examples of counseling documents be used to educate potential borrowers.

MBA appreciates the opportunity to present its views on this important potential option for FHA. We look forward to working with the subcommittee and Congressmen Tiberi and Scott on H.R. 3043.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Petrie can be found on page 54 of the appendix.]

Chairman NEY. Thank you.

Mr. Wilson?

STATEMENT OF DAVID WILSON, PRESIDENT, WILSON CONSTRUCTION LLC, TESTIFYING AS PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. WILSON. Good morning, Chairman Ney, members of the subcommittee.

On behalf of the 225,000 members of the National Association of Home Builders, I want to thank you for the opportunity to testify today.

Let me begin by saying that the National Association of Home Builders strongly supports H.R. 3043 as introduced by Representative Tiberi. We believe passage of this proposal would mean that some 50,000 families would be able to achieve homeownership who otherwise would be denied this opportunity. Furthermore, it enables FHA to do so in a prudent manner without negatively impacting the mutual mortgage insurance fund or the general insurance fund.

This legislation continues a long tradition of innovation by FHA by addressing a primary obstacle for preventing minority and low- and moderate-income families from becoming homeowners. According to the Census Bureau's study, one of the top reasons why families and individuals cannot afford to purchase a home was the inability to come up with the up-front cash needed for closing. Data from the Federal Reserve indicates that 87 percent of all renters have less than $50,000 in wealth available to pay for a downpayment and closing costs on a new home. For minority renters, that figure rises to 94 percent. With so little wealth, and absent some form of downpayment assistance, it is difficult for a large number of renters, especially minority renters, to become homeowners.

In addition, many of these same families are not served by the conventional mortgage products. Currently, the chief way to address downpayment barriers for FHA borrowers is through downpayment assistance programs facilitated by third parties. While these programs have contributed positively to homeownership expansion efforts, more options are needed. FHA studies have indicated that loans to homebuyers who receive third party assistance do not perform as well as other FHA-insured loans.

The higher loan default rate is not in and of itself a problem since these efforts are aimed at serving a borrowing population that has traditionally been underserved. However, loans assisted by these downpayment assistance programs do not compensate the FHA insurance fund for their increased risk. H.R. 3043 addresses the downpayment hurdle, while allowing FHA to establish mort-

gage insurance premiums and underwriting and counseling requirements targeted to this financing program.

I would like to take a moment to expand on why NAHB further believes this program can be carried out in a safe and sound manner without harm to FHA. First, the ability to differentiate between high- and low-credit risk borrowers has been enhanced through technology and advances in automated underwriting such as FHA's Total Mortgage scorecard. This allows lenders to better evaluate borrowers before bringing them into the program.

Second, the risk to FHA can be mitigated through risk-based pricing such as proposed by HUD in the form of higher up-front and/or annual mortgage insurance premiums. HUD estimates that this approach results in no net cost to FHA and increases the monthly payment on a $100,000 mortgage by about $50 a month.

Finally, housing counseling can lower the risk to FHA by ensuring the prospective first-time homebuyer understands the responsibilities of actually being a homeowner. The value of these programs is well documented. NAHB is pleased that H.R. 3043 would include condominiums and cooperatives as eligible options. In many communities, these homeownership alternatives are more than within the reach of low-and moderate-income families, just as single-family detached homes, and can provide the same wealth-building community and development benefits.

Mr. Chairman, thank you again for the opportunity to share our views on the zero downpayment pilot program. The members of the National Association of Home Builders work daily with families who want to achieve the American dream of homeownership. By implementing this program as a limited-scope pilot, Congress can give this program a chance to prove its worth.

We look forward to working with the subcommittee.

[The prepared statement of Mr. Wilson can be found on page 79 of the appendix.]

Chairman NEY. Thank you.

I am going to yield. It is Mr. Tiberi's bill. Mr. Scott is not here, but I am going to yield for questions first to Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman.

For the record, I would like to submit my opening statement.

Chairman NEY. Without objection.

Mr. TIBERI. Thank you. I apologize for being late. I am in a markup in another committee. I want to thank you all for testifying today. I want to expand a little bit on Mr. Petrie's and Mr. Wilson's testimony that I was able to hear.

First off, Mr. Newman, thank you for being here today. We share in our effort to try to put people in homes. In hearing your testimony and looking at testimony, I was not quite sure if you are for or against the bill.

Mr. NEWMAN. We are for the bill.

Mr. TIBERI. You are for the bill?

Mr. NEWMAN. We support the goal of the bill and we are supporting the bill.

Mr. TIBERI. Okay. Your organization and I have talked in the past. I know you have had discussions with others and our House leadership. One of the issues that you talk about is a concern of cost to the government. The issue of foreclosures has come up. In

Ohio, in fact, there has been a group that has done a study on foreclosures that has yet to be printed, which I am going to touch on. What was interesting is you mention in your testimony, underlined, "It is important to note that all of these services have been provided free of charge to homebuyers and have not used government funding or taxpayer dollars."

Can you kind of explain how you all worked, for the record, for the committee?

Mr. NEWMAN. Our downpayment assistance program works with lenders and sellers primarily. The buyers go to lenders who have to be qualified by lenders or brokers to get a loan. The lender makes a determination as to whether or not this individual needs some downpayment assistance to be able to qualify for the loan. On the other side, builders and sellers enroll their homes in our program and say that they are willing to offer downpayment assistance to widen the pool of potential buyers.

So the seller and the lender come together and make an agreement that in effect they are willing to help out and meet the seller's needs. We give a gift to the buyer, and in turn the buyer is able to provide that to the seller when they close.

Mr. TIBERI. Where does the gift come from, your gift?

Mr. NEWMAN. The gift comes from a pool of funds that we have. So it is a revolving pool. So sellers who have used the program, who have registered with us maybe a year ago, maybe 4 months ago, they have paid us a service fee for the transaction that we do. It goes into a fund. That fund is used for future buyers.

Mr. TIBERI. So let me ask you this. My neighbor last year sold their house for $168,000 or $169,000. Their house was listed in the low-$160s. They ended up selling to a first-time homebuyer who participated not in AmeriDream, but in a program similar to AmeriDream; bought their home. The seller, my former neighbors, actually ended up gifting to the program and in exchange for that gifting, they raised the price of their home to around $168,000, which was then financed by the buyer through this gift program. Is that how it is normally done?

Mr. NEWMAN. That is not something that we condone at all. We do not advocate that. We depend tremendously on two people in the transaction, really three. It is the lender to qualify the buyer and the terms. The lender is also going to get the appropriate appraisal for the property. After all of that is done, then they reach out to us for the gift amount. We are not involved in the qualification of the buyer nor are we involved in the listing or the appraisal of the property. We do not condone, and we do not advertise and we do not do any outreach on the product to suggest to individuals to increase the price of the home.

Mr. TIBERI. Here is my concern is that, let me go to the foreclosure point, because you say there is no cost to Government funding or taxpayer dollars. The study being done in Ohio which has not been printed yet, my understanding in talking to people who are doing it, shows that Ohio has the second-highest foreclosure rate in the country, and central Ohio is pretty up there.

They are tracking downpayment assistance programs as being a large part of that; that people are going into these homes and even though they are getting the downpayment assistance, they are pay-

ing an inflated price for the cost of their home, whether it is a newly built home or whether it is an existing home, it is toward the higher price in that particular neighborhood.

Most of the loans that are done, at least through the study, are financed by FHA. I assume most of the homes that you all are involved with are backed by FHA. So then the government does have a hook. Taxpayers are on the hook for these homes that are foreclosed. So I guess my point is, and my time has expired, and I appreciate the chairman yielding his time to me, my point would be that if we looked at this in a larger picture, that we in this Financial Services Committee have an obligation to protect taxpayers through FHA, at the same time of trying to provide a lofty goal of homeownership.

That is why I introduced the bill, is to make sure that we here in this committee and this Capitol could make sure that at the same time as providing homeownership to as many Americans as possible, protect taxpayers and protect the viability of FHA. If we control it, I think we have the ability to do that. I hope that most members of this subcommittee and full committee look at the issue more broadly to find out exactly how the market works today.

I yield back the balance of my time, Mr. Chairman.

Chairman NEY. Is there anything you want to respond to?

Mr. NEWMAN. Well, thank you for your comments.

Chairman NEY. Briefly, because we are going to move on.

Mr. NEWMAN. Very briefly.

Having not had an opportunity to read the study since it has not been released yet, I think that our response would be that we have long sought and heard the same type of statements and comments that have been made, and we have long sought to work with FHA to identify the actual cause of the problem and to come up with solutions or recommendations as to how to address that.

We continue to reach out, and with the new Commissioner of FHA we are hoping to be able to reach out and develop some sort of partnership to identify the true causes of the problems, not just the results, but the true causes of the problems and see if there is a way that we can work together to help mitigate that. So we look forward to being able to address some of those issues.

Mr. TIBERI. I hope this is an issue that we can work on together.

Mr. NEWMAN. I hope so as well.

Chairman NEY. Mr. Petrie?

Mr. PETRIE. Mr. Chairman, can I respond also?

I would just like to add onto what the Congressman's point is. Indiana last year was the number one foreclosure State. I do not know if we are one or two now. We had some research also done and completed that showed that we are a high-FHA State, using FHA, and that the downpayment assistance loans were twice the rate of foreclosures than the others. So our data shows the same things. I think the HUD IG did a report 2 years ago. They say that some of their data is flawed, but it showed that a higher rate of foreclosure was in there, too, with these types of loans. So we think this program will be very helpful in working to reverse that situation.

Thank you, sir.

Chairman NEY. Mr. Shear?

Mr. SHEAR. At Chairman Ney's request, we are doing a study now on downpayment assistance. I would say that the situation that you brought up involving your neighbor is a matter of concern that we have in looking at downpayment assistance. I do not have results to report, but downpayment assistance has become such a large share of newly originated FHA-insured loans.

We do have the concern of the relationship with the seller and we do have a concern as to how that can affect appraised values, and how the premise of the program, which is a promising premise, is to put equity in the home for the borrower. One of the things that we are assessing is the performance of these loans, but we are also looking at whether the premise of whether equity is being put into these homes in the sense of true equity, whether that is occurring.

Mr. TIBERI. Mr. Chairman, I just want to thank the gentleman, because one of the criticisms last year that was brought to the attention of our leadership in the House was the fact that my program put a person into a home with no money down and the value of the home, with costs, was less than the payment, the borrowing amount.

My point has been, and my neighbor is a perfect example, is the fact that my new neighbor has equity in the home through a downpayment assistance program, but the problem is what he paid is much higher than the value of the neighborhood. If something would happen and he forecloses, he is in the soup and so is FHA. That is something that has not been connected to a lot of folks.

Whether it is a newly built home, and there are unfortunately in Columbus, Ohio, subdivisions where this has happened, or an existing home like my neighbor, where the purchase price that he paid is far higher than the value of the going rate in that neighborhood. So thank you for understanding that.

Mr. SHEAR. Representative Tiberi, I thank you for your comment. What I will point out is that in that situation, when we say what is the true loan-to-value ratio, it is based on the notion of really what is the true value of the house. So in that situation, we would question, not based on the sales price, but based on some sense of the true valuation of the house, is there real equity in the home.

Chairman NEY. Thank you.

Speaking of successful lawmakers, our two colleagues to the right passed the Fair Housing and HOPE VI last night, so maybe Mr. Tiberi and I ought to consult with the two of you on how to do that.

Mr. Green?

Mr. GREEN. Thank you so much, Mr. Chairman. I assure you as a neophyte I was very fortunate. I was blessed because the truth is, I did just about everything that I could to assure the failure of the bill.

[Laughter.]

I had a great staff and great bipartisan support, Mr. Chairman, and I thank you so much for your kind words.

I would also like to thank our Ranking Member, Congresswoman Waters, and thank the members of this outstanding panel. You have all spoken well.

I would like to know, without question, whether everybody does indeed support this bill and if there is someone who does not, if you

will kindly extend a hand into the air, I will address you. Is there anyone who does not support it? Okay. I thought so. Everyone supports it.

There is a provision in the bill on page 13 starting at about line 3 that deals with suspension in the event of what I would call a default rate that exceeds 3.5 percent. My question is: Does this language sufficiently cover concerns addressed about the inability of some persons to pay a downpayment? Would that help make you comfortable with the bill itself or does that create an additional concern by it being there?

Let's start with Mr. Wilson.

Mr. WILSON. Thank you, Congressman.

No, we think that is a safety catch there that if the program is not successful that then you have time to adjust for it. We certainly do not want to create, and I think Congressman Tiberi said it, added value to houses that really are not there that could create a housing bubble, if you will. This will allow the program to move forward. If it starts to get to that 3.5 percent rate, then you all could re-evaluate it to say that maybe we are not doing the right thing here; that we are having higher foreclosures than we really want with this program. But we truly support the program from the standpoint that it will allow a lot of underserved families to have the ability to own a home.

Mr. GREEN. Before the next person responds, I would like my colleague, Mr. Tiberi, to know that I greatly appreciate the energy and effort that you have put into this. I would echo that also to my colleague who is not here, Congressman Scott. You are to be commended and I truly compliment you.

Now, to Mr. Shear.

Mr. SHEAR. Okay. You asked the question, do we support the bill. We think it is a prerogative of Congress of whether you want to offer zero downpayment products. There are certain questions that come up having to do with the weighing of risk versus the mission of the FHA program. But we do firmly support the piloting nature of the bill. We are very much in support of the pilot nature of this bill.

In terms of what I will call the "trigger mechanism" for how well the loans perform, I would say that we agree with the notion of having a triggering mechanism that if the loans do not perform very well that you might want to, in a sense, further limit the program. We would be glad to assist this committee, in terms of the legislation, if you wanted to consider other types of trigger mechanisms to serve that purpose. So I will just point out a few.

Even though I will refer to defaults or delinquencies, HUD gets data on 90-day delinquencies. Even though many delinquencies are cured and do not lead to a claim on the insurance fund, delinquencies can be a good early warning indicator of how well loans are doing. So something that might serve the purpose better would be to look at certain delinquency data, rather than the claim rate.

If you wanted to use claim rates, another possibility would be to have a triggering mechanism which, what we tend to look at are what we call cumulative claim rates. So let's say a lot of loans were made in 2006, we would look at claims in 2006, 2007, 2008 in a cumulative fashion, rather than in a 1-year window each year. This

is just a technical observation of what could be done with this triggering mechanism—

Mr. GREEN. I do not mean to disrupt. In fact I do, I apologize. I have a limited amount of time and I would like to give the others a chance to respond.

Mr. SHEAR. Okay. Thank you.

Mr. GREEN. Okay. But thank you very much.

Mr. SHEAR. Okay.

Mr. PETRIE. The Mortgage Bankers Association, on the surface, does not have a problem with the 3.5 percent claim rate, but I would like to state that FHA for 70 years has successfully designed products that have provided substantial revenue to the Federal Government and no cost to the taxpayers of the United States. Whenever you have a pilot program, the purpose of a pilot is to give the designer the ability to structure a program. If you are overly prescriptive, you take away their ability to manage the risk. This is a prescriptive measure. A 700 credit score is a prescriptive measure. You basically take away the power of FHA to design what is appropriate.

The mortgage insurance premium for this product is already priced higher than it normally would be, and by setting a pilot limit of 50,000 loans, you have already kind of capped off the top of your risk. Any other measures become more prescriptive, which limits their ability to manage risk, and I think we would like it less prescriptive, rather than more prescriptive.

The other thing, too, the way we look at it, the MMI insurance fund is to cross-subsidize loans. When you are trying to reach down farther, you are going to take on higher risk, but that is the intent. The intent is to reach down farther to meet those people that can make the monthly payment, but may not have the downpayment. So you are going to have more risk, but you have priced it for that and you have limited your risk by the number of loans. To throw in a lot of other measures just becomes prescriptive and handcuffs FHA and would stop their creativity to best serve this group. I would think we want to be less prescriptive now that you already have your limits in place.

Thank you.

Mr. GREEN. All right.

Mr. NEWMAN. We certainly support having that claim cap on there. I differ a little bit with my fellow panel-member in terms of having a little bit more prescriptiveness in it. I think the role of FHA is to implement some protective measures, but I am not sure that their first goal is to generate revenue for the government as much as it is to ensure that the folks who are most at risk have the best scenario of getting into homes and being able to stay in their homes. By putting the onus on them to continue to generate revenue for the government, sometimes they may have differing agendas. Their first agenda should be the protection of the homebuyer in helping them to get into a home and to stay in their home.

I think that putting a little bit of prescription in there also helps to mitigate some of the concerns that folks may actually have about the downpayment assistance providers. Right now getting the appraisal of a home at a certain height is not the downpayment assistance's fault or it is not necessarily FHA's. The people who do

that are appraisers. The people who qualify the individuals for the gift amount will be the lenders. The same thing in this model. If you take away some of those prescriptions, you will still have some of those same players in there who can be as creative as they have been, but sometimes not in the best interests of the homebuyer.

It is also important to remember that this bill, as well as everything else that we have done in downpayment assistance, is geared toward the people who are most at risk and invariably have the higher probability of making a claim. So having some of that cap on there so that it does not lose a lot of control in spite of making additional revenue, as was mentioned that they have higher costs in there, is not a bad thing to have in there.

Mr. GREEN. Yes, ma'am?

Ms. BOWDLER. I will only briefly echo some of the comments. I think that the cap is a good idea. NCLR is very supportive of the idea of running this as a pilot program. One hundred percent financing is risky for most people that do it, so we do want to make sure that we proceed carefully and cautiously, keeping in mind the vulnerable families that are most likely to use FHA.

Mr. GREEN. Thank you, Mr. Chairman. You have been more than generous with my time and your time. I thank you very much.

I yield back.

Chairman NEY. Thank you.

Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I think the first question I would like to just throw out to the panel is one of the things that when we talk about what is causing low homeownership in our country, although it is increasing and I am proud of that. In fact, I have been a homebuilder for a number of years, so if there is anybody more pro-housing than Randy Neugebauer, I do not know who is. But I am interested in making sure we do this the right way.

The thing that I begin to wonder, is it downpayment or is it credit quality that is keeping a lot of people out of the homeownership business? When I talk to my friends in the lending business, I hear more of them talk about poor credit quality, poor credit scores than I hear about people not having the downpayment to get into those homes.

And then when we start talking about going to a zero downpayment scenario where we know the risk is going up and we talk about raising the bar on what those credit scores are. So if we do get to that point, if we have a program that says we are going to let you in for zero down, but we are going to put very high restrictions on your credit scores, how many people are going to fall into that grid?

Ms. BOWDLER. I think, at least within the Latino community, they face a number of barriers to becoming first-time homebuyers. Affordability is just one of them. Others include credit scores, as you mentioned, but we have a little bit different problem with credit scores in that too many Latino families have thin or no credit scores. In other words, they do not have enough information in their credit file. When you run a traditional automated underwriting systems, it comes out as a zero. So they may be a perfectly

good credit risk, but it is hard to gauge that with the automated underwriting system.

I just want to go back to one example. When NCLR began their pilot program, Home To Own, which grew into our counseling network, we helped over 400 families become homebuyers. We used a combination of downpayment assistance, individual counseling, and flexible mortgage products, which we piloted with Fannie Mae. Afterwards, the Morrison Institute of Arizona did a study to see what was it that helped families get into homes. They found that while downpayment was an issue for a lot of families, it was not their largest barrier. In fact, it was the individual counseling and the flexible mortgage products that were the most help in overcoming their barriers.

Mr. NEUGEBAUER. Okay. Others?

Mr. SHEAR. We have not analyzed it directly, but we have looked at some research that looks at that question. Most of the research does not link together the ability to make a downpayment with credit score. What we do observe is that from a standpoint of risk mitigation, there are tradeoffs involved. So we do not know how large the population is, but there could be a number of potential homebuyers whose homeownership could be facilitated if downpayment requirements were reduced, and with higher credit scores being required.

Mr. PETRIE. One of the things that you point out regarding homeownership, homeownership today is the highest it has ever been.

Mr. NEUGEBAUER. That is right.

Mr. PETRIE. I think with this program, what we are trying to do is reach down to a segment that cannot conform to conventional markets. They are not going to have the higher income. The conventional markets do not serve lower incomes as well as FHA as shown they can do, or the lower credit scores. They have higher credit scores, especially when you combine it with the 80–20 or the equity on the backside of that. So even though there are a lot of different downpayment programs, some of these people are locked out of that because their credit scores may not be high enough or they have other issues there.

One of the things that we look at, and I have served 8 years on the board of a neighborhood housing partnership in Indianapolis where we did housing counseling and provided secondary financing to get lower-income and minorities into homes. What you end up with is two mortgage payments, two different types of lenders, different issues. This product is very good from the standpoint that you have one fixed-rate loan for the full thing so it is not confusing to the borrower.

They do not have two different lenders they have to deal with. Plus the loss mitigation issues that HUD provides, that FHA provides with regard to forbearance of interest or special forbearance to keep them in the home longer, that is kind of why their delinquency rates are higher is because they do keep these people in homes better than some of the conventional or other types of mortgage products out there.

So we think this product answers a need in the marketplace for those types of people that we can get in, but may not be able to

access it today, or if they do access it, at a riskier type product that may put them in more harm's way. So we think that we are on the right track here and that is why we are so supportive of this program.

Mr. NEUGEBAUER. Should the mortgage insurance premium be raised across the board? I think in Mr. Tiberi's bill I saw something that led me to believe that we were talking about moving from a rate of 1.75 percent to 2.25 percent or something like that. Are we talking about making that the MIP for all FHA loans or just for this one?

Mr. PETRIE. Just this product.

Mr. NEUGEBAUER. Just for this product.

Mr. PETRIE. The reason why we are doing this product is it has been scored as a higher-risk product. I would like to point out that the current product that is out there generates hundreds of millions of dollars over its cost, so that is not what we would believe is appropriately scored for the risk. The point being then that these products, this may be higher-priced than it needs to be, but that is what HUD will determine or FHA will determine over time. It then may be able to be brought down.

Right now, they are just saying based on the way things work, CBO, OMB, how things are scored, they have to be at this level so it is kind of a break-even. But in essence, there are plenty of funds in the insurance to cover these 50,000 loans if there is any type of default rate.

So the point going back is why do we have to have a 3.5 percent claim rate to suspend the program when there are sufficient funds to cover losses of any type in the insurance fund for this type of program? It should be used because the intent of the FHA is to broaden homeownership, so those funds should be used to broaden at maybe greater risk to the taxpayer, but it is going to be covered. You are not going to have to go back and get funds from taxpayers to do it.

Mr. NEUGEBAUER. Mr. Chairman, my time has expired.

Mr. TIBERI. Mr. Chairman, can I just add?

Chairman NEY. Sure.

Mr. TIBERI. We would love to have you run for Congress, by the way, and come up here and help us on this.

[Laughter.]

Chairman NEY. Just not in our district.

[Laughter.]

Mr. Davis?

Mr. DAVIS OF ALABAMA. I second that emotion.

[Laughter.]

Thank you, Mr. Chairman.

Let me begin by complimenting my friend from Ohio, Mr. Tiberi, and Mr. Scott from Georgia for what I think is a good bill that has very strong bipartisan support. Hopefully, it will have a better fate than it did in the last Congress. I want to try to use some of our experience with this bill to see if it can give us some guidance on some regulatory issues that we are facing regarding the conventional mortgage lending market.

The instinct of this bill, if I understand it correctly, is that we are going to take a group of relatively objectively high-risk poten-

tial consumers, potential homeowners. We are going to give them the benefit of this product and then we are going to put certain requirements in place that minimize the risk, an element of mandatory counseling, for example.

It occurs to me that this may give us some guidance on another issue that we are facing. Right now this committee and this Congress are trying to figure out how we regulate the conventional mortgage lending market, particularly in the context of subprime; particularly in the context of another class of products that are available for potentially high-risk consumers.

One of the features of this bill is that it contains a mandatory counseling element. I know that there is some feeling that it could be made stronger in the sense that there is a thought that the counseling should have to be completed, not just started, before the loan is approved, but there is a mandatory counseling element here.

Let me ask some of you on the panel, and perhaps we can start with you, Ms. Bowdler. Does this give us some guidance as to how we ought to be thinking about subprime loans? Does it make sense that if we require an element of mandatory counseling for these kinds of loans that we ought to think about mandatory counseling for subprime loans?

Ms. BOWDLER. There are really two questions there, so let me start with the first one, going to protections on FHA loans. I think that is what you are getting at. We have all heard stories and we have talked about some of the stories about the abuse on FHA loans. There are a lot of really bad stories out there. NCLR, for example, recently completed a report that looked a predatory lending in the Latino community and we found that like a lot of other studies that Latinos were in fact over-represented in subprime and FHA loans.

That said, I think that this whole committee recognizes that what we really need are stronger protections and housing counseling is definitely not a panacea to predatory lending. That said, in the absence of stronger protections at this point, housing counseling is a really effective way to inform consumers and help them make educated decisions about their loan products.

Mr. DAVIS OF ALABAMA. Should it be mandatory in the context of subprime loans?

Ms. BOWDLER. I think that I would recommend that every first-time homebuyers receive pre-purchase counseling. I do not think that you can make it mandatory for every loan. There are a couple of reasons for that. In part, it is because the counseling infrastructure at this point could not handle that volume. So I think that we would have to look at what would be the best way, how could we set families in counseling agencies, how can we set them up for success to deliver that kind of service. I think that we would be getting ahead of ourselves to mandate counseling for millions of borrowers without them having access to quality counseling.

Mr. DAVIS OF ALABAMA. Could we put triggers into the subprime market that if the loans had certain characteristics that they would be required to undergo counseling? Maybe instead of having the whole pool of loans that fit that category, the loans that had certain characteristics or certain criteria?

Ms. BOWDLER. I think you could do that. What I would want to caution against is the use of counseling as a deterrent to getting financing. We definitely do not want to see that happen, either. So we would have to be careful about how we structure that.

Mr. DAVIS OF ALABAMA. Any quick reactions from the rest of the panel on that question?

Mr. PETRIE. As part of my role as chairman of the MBA, I did a housing panel in Gary, Indiana. We had all the various housing providers, not-for-profits, counselors. We had all the counseling agencies, the consumer credit counseling agencies. We were all sitting around the table talking about how we can better improve housing in Gary, Indiana, with downpayment assistance and whatever.

What came up to a certain respect is that when people had poor credit and they were counseled to, well, it is going to take a year; we want you to work another year to get your credit better. When people want to own a home, they will do anything to own a home. They do not want to wait a week, a month, a year or whatever. So the counseling aspect, you are creating a hurdle which they are going to get around different ways. When they want to get the home, they are going to do that.

I would like to point out that although FHA and subprime overlap a little bit, a lot of the borrowers are different types of borrowers. They have different types of issues with their credit that may not be the risk profile that we are talking about for this type of program. But we would not be in favor of mandatory counseling from that standpoint for all FHA loans because we do not know the relationship to the problem of foreclosure or delinquency.

Mr. DAVIS OF ALABAMA. Let me close with one quick question. I recognize that my time is a little bit over, but one other aspect that I want to briefly touch on. My assumption, and correct me if I am wrong, but my assumption is that FHA loans do not include prepayment penalties. Am I right about that?

Mr. PETRIE. That is correct.

Mr. DAVIS OF ALABAMA. Okay. One of the issues that we are debating obviously in the context of regulating the larger mortgage lending market is the utility of prepayment penalties and whether or not prepayment penalties provide some special problem for consumers. Does the fact that FHA loans do not include prepayment penalties suggest to us that we ought to be more aggressive in our regulation of prepayment penalties in the conventional market?

Mr. PETRIE. Actually, I am a multifamily lender. We actually use prepayment penalties to yield what we call "call protection". The purpose of call protection is to reduce the interest rate because the investor will take a lower amount of interest if they know they have a steady stream. The purpose of prepayment penalties is to reduce the interest rate. The way we look it, you are taking an option away from the borrower of this interest rate or that interest rate, but I have to stay in it.

Mr. DAVIS OF ALABAMA. Why not have them for FHA loans then?

Mr. PETRIE. Pardon?

Mr. DAVIS OF ALABAMA. Why not have them for FHA loans?

Mr. PETRIE. FHA precludes that.

Mr. DAVIS OF ALABAMA. That is begging the question. Is that a good thing?

Mr. PETRIE. In multifamily, the type of loans I do are FHA and they do have call protection.

Mr. DAVIS OF ALABAMA. Okay. Just the final point, as my time is about to run out, do any of you think that FHA loans ought to allow prepayment penalties? Ms. Bowdler, I am assuming as the consumer advocate on the panel you certainly, I assume, would not think that FHA loans should allow prepayment penalties.

Ms. BOWDLER. No. Actually, we would not recommend prepayment penalties for FHA. I will say that I know that there are the economic tradeoffs that Mr. Petrie was referring to. That kind of discussion goes on in the marketplace all the time, and families have to make decisions based on that. NCLR want to work with this committee as they try to figure those things out.

What I will say about prepayment penalties, though, is that all it takes is to get them attached to one bad loan, and what our counselors see all the time is when an abusive loan comes through, it is the prepayment penalty that does not allow them to help the family, that makes it too expensive to refinance into another product. At least in FHA, you have the advantage where if they were put there by mistake for whatever reason, then you can easily refinance out of it.

Mr. PETRIE. One final point on prepayment penalties with FHA, we would not be for that because FHA predominantly serves first-time homebuyers. We want them to be able as quickly as possible refinance into a conventional market and lower their rate. That is really the intent of the program, to get them in and then move them down the stream to a better interest rate however they can do it.

Mr. DAVIS OF ALABAMA. Mr. Chairman, I think my time has expired, unless one of you wanted to give a final answer.

Mr. NEWMAN. I just want to piggyback on that because that goes back to your first question about the homebuyer education piece of it. Again, if the buyer knows about those realities and some of the opportunities available to them, it is very important. We cannot underscore the importance of education before you get into your first home.

I have to absolutely concur that if there was going to be any mandatory homebuyer education, it would have to be on the first-time homebuyer education. I would not just limit it to subprime. I did not go through a subprime. I had a couple of degrees when I bought my first house. Going into the homeownership experience was the most interesting thing I ever went through in my life because it was a black box. I walked in and came out shaken.

So I just think that if we are going to talk about education, it is important for all first-time homebuyers to have some level of experience. I do not know if we have to make it required, but at least they are exposed to some of the minor details or the higher details about the homebuying experience so they can be successful homeowners.

Chairman NEY. Thank you.

Mr. Pearce?

Mr. PEARCE. Thank you, Mr. Chairman.

I think we are all working toward a common goal here of deepening that homeownership across the society. I have a couple of questions here in the application.

Mr. Shear, what is the cost associated with this program that we are talking about, the zero downpayment? In other words, the cost per person, cost per loan, cost per whatever?

Mr. SHEAR. We have not costed-out the program. I know that the Congressional Budget Office made estimates for a previous bill, but we have not looked at the cost of the program.

Mr. PEARCE. Mr. Petrie, I guess you might be the next one. If we are to guess nationwide about non-performing loans, how big a chunk of change does that take? Do you have any idea? You may not know.

Mr. PETRIE. Are you speaking with regards to FHA?

Mr. PEARCE. Yes, the FHA.

Mr. PETRIE. I can tell you right now. According to our research, FHA delinquency dropped from 13 percent to 10.5 percent. Foreclosures are less than 1 percent. So they are declining. Delinquency is a lagging indicator. Since the economy has improved, you would expect delinquencies to go down and that is exactly what is happening, even in the FHA marketplace. So that is happening.

With regard to your question on cost, I believe the CBO scored this bill at $38 million over 5 years based on the insurance premium and the risk that they have. So you can take $38 million and divide by 5, that is the annual cost over 5 years. That is the total cost for 5 years.

Mr. PEARCE. I guess that would be very similar. We have gotten numbers that show that in 2004 there was $7.2 billion paid out to mortgage service providers. The average claimant size was $93,000 in the mutual mortgage, and then special mortgages were $83,000.

Mr. PETRIE. I would like to point out that there is no cost. After all those claims are paid, there are still hundreds and hundreds of millions of dollars that flow to the treasury from these programs.

Mr. PEARCE. If there is no cost, why do we have a cap of 50,000? It seems like if this is a no-cost proposition, we should really have 10 million instead of 50,000.

Mr. PETRIE. The intent, I think, is to pilot the program. I think if they going to say we are going to moderate the risk, then you sort of cap to allow them to work through the program, design it the best way they can. This 50,000 allows the Congress to control the maximum extent of the risk.

The other point I was making, though, and I guess you are making the point, is not to be prescriptive with other terms and conditions if you have capped it at 50,000 loans.

Mr. PEARCE. No, my point is that if it is no-cost, which I have heard that said, why are we limiting it? I think there is a cost, frankly. I think there is a cost. I think that we need to be aware of that cost going in. None of us would want to step in front of the idea of ownership, but we need to evaluate correctly. That is the reason I started with Mr. Shear, and just wondered if you all had done any evaluation. I don't know.

Do you evaluate where this money goes? In other words, when the FHA or when HUD repossesses, when they go in and bail out, our figures are that when they resold properties that they have

gone in and taken because they were not performing, that HUD lost 29.3 percent on those sales, an additional $2.1 billion. I do not mind what we are doing, but I think that we need to get our numbers on the table. We need to be a little bit objective and honest about what we are saying here.

Mr. SHEAR. Okay. I appreciate the question. One of the studies that we are doing for this subcommittee is looking at questions of the MMI fund and in particular looking at some re-estimates that were done.

With respect to your question, when beginning a new program, what does it cost? Certainly, we call the FHA program a negative subsidy program, but even if that negative subsidy in a sense becomes smaller and starts moving toward the subsidy disappearing, any new activity that it goes into if it leads to a lot of claims, there is a real cost on the fund. There is a real cost to the taxpayer. There is certainly an economic cost to that. And then you bring up the question, is it really serving the mission.

So in terms of looking at this question, this is a program where we think there would be higher risks than maybe some of the other activities that FHA does. Those risks are really largely unknown. So one of the reasons to have a pilot is to see how well the program performs, because let's say if you had a program and you did not limit and you found out that the experience from that program was one of very high claims, then it is very hard because those claims tend to evolve many times 3, 4, 5 years after a loan is originated or a group of loans is originated.

So from a cost standpoint, there is a real cost to the program and it is a question of how do you manage a program where the risks are hard to determine.

Mr. PEARCE. Mr. Chairman, I will wrap up with this point. I need to follow closely that discussion. I appreciate the responses from both the panelists. But the idea that we have to deal with is that if we are getting these kinds of over-valuations in one sector, I do not know exactly, we have to deal with that. We have to be aware that in small increments, and maybe a very small increment of instability is added into our overall financial market.

If we get a small increment here and we get a small increment there, and a small increment from GSE's and a small increment from wherever, I think that we need to be very aware of what we are doing and the different increments, and what instability that we are building in for ourselves. About 3 or 4 weeks ago I made the point that in some of our Basel work, we are not really changing the risk. We are exporting the risk outside the field of measurement of the formula and we are saying it is good. I am sorry. It is not good, and that has been kind of the direction I wanted to go in these questions.

Thank you, Mr. Chairman.

Mr. TIBERI. [presiding] Thank you.

Ms. Waters?

Ms. WATERS. Thank you very much, Mr. Chairman. I am sorry I could not be here earlier. It appears that we have more and more committees meeting at the same time. We are constantly running from one to the other to try and participate, even if in a small way.

The legislation that we are discussing is familiar to us all because we voted on it before. We all appear to believe that there are people who work every day, who pay their bills, and who deserve to have a home, yet they cannot afford downpayments, just as we know there are people who work every day and they cannot afford the first and last month's rent to get into rental units.

Therefore, this bill speaks to what do you do about hard-working Americans who have a history basically of paying their bills, who are credit-eligible, who have good credit scores and a lot of other things, to get them into homeownership. So I am supportive of this. I suppose there is some disappointment about the fact that it is now narrowed to more of a pilot project rather than a program that we have faith in that we wish to put out there.

Some of the questions that have been raised I suppose are legitimate, particularly those who feel that we are creating a kind of risk that we do not understand and somehow must be very cautious and very careful. I do not quite share that view. However, certainly if we cannot get the whole enchilada, we can take a piece of it and move forward to see if we can't expand these homeownership opportunities.

My question about this pilot is, how are we going to market it in ways that people have equal opportunity to have access to it? If we are only talking about, as I understand it, 50,000 in the pilot; is that what we are talking about? How do we propose to market the program? Who do we market to? How does it work? Does anybody know? I guess I am addressing it to the Chair.

Mr. TIBERI. We determined, the sponsors determined that to move the bill forward, we would need to compromise. So one of the things that we hope to do through this process is figure out a way to work with FHA and the Government Accountability Office to prove that we are going to create a program that will be successful at the 50,000 mark level. One of the concerns that some have shared, Ms. Waters, is that, and maybe I can let the panelists speak, is that there is a larger risk to the zero-down borrower than any of the current programs, which I happen to disagree. I think you and I would share that. But nevertheless, that concern has been brought up.

So by putting the 50,000 number on it, we have tried to compromise just to move the bill forward and demonstrate the fact that through our proposal that I, in fact, believe, and this is me personally, that by some of the safeguards in the measure that we can demonstrate that the foreclosure rate and the homeownership rate will be stronger, meaning there will be less foreclosures, higher homeownership, permanent homeownership, with the safeguards that we put in the bill, and that this will be a program directly through FHA, and that there will not be homes that are overvalued in the marketplace; that they will be valued at their appropriate level.

Ms. WATERS. Well, I would like to thank the gentleman for his comments. I thank the panelists for showing up here today. Again, like I said, this is a political process where some concessions and compromises oftentimes have to be made to move new ideas forward. I do not like it, but I understand it, and we will just move forward.

Thank you very much.

Mr. TIBERI. Mr. Cleaver?

Mr. CLEAVER. Thank you, Mr. Chairman.

The issue that I am more concerned about is the foreclosure rate. I am wondering whether the bill addresses in any way a means by which we can address the foreclosure rate. If not, are there recommendations that you might have to strengthen the bill?

Ms. BOWDLER. I believe that the legislation does include a provision by which a client or a borrower would be able to let the lender know the counseling agency that they have been working with. That counseling agency would take on some responsibility. The lender would agree to this idea and then in the event of 60-day delinquency, would notify the counseling agency which would get in touch with the borrower and try to help them rectify their situation.

Mr. CLEAVER. But is there a way that we can strengthen the counseling provision in the bill? Do you think that it is already at maximum strength?

Ms. BOWDLER. No. We made a couple of recommendations. One would be strengthening the counseling agencies and making sure that they have the capacity to deal with the volume of clients that they are likely to see in conjunction with the legislation. Also, 60-day delinquency, by the time you are 60 days delinquent, there could be problems that are beyond repair. I would not even mind seeing 45-day delinquencies, getting in as early as possible. I know that is kind of a weird mark. Usually it is 30 and 60, but really the sooner that you can get in, especially with vulnerable families who are going to have very little equity in their homes, in fact probably no equity, especially if it is in within the first couple of years.

Mr. CLEAVER. Okay. The word "grace period," you are saying it should be 45 days?

Ms. BOWDLER. Well, I am saying, the way the legislation is now, if I am understanding it correctly, is a borrower can come to the table with their counseling agency. If the lender agrees, then the lender can send delinquency notice to the counseling agency, and allow them to contact the family.

Mr. CLEAVER. Okay.

Ms. BOWDLER. What I am saying is that especially with an FHA loan and especially with a zero-down program, where you are going to have little to no equity that could cushion you in this kind of situation, the earlier that a counseling agency can help a family is always better.

Mr. PETRIE. Congressman, FHA has a better mitigation of foreclosure than any other conventional-type loan. FHA has set up their loss mitigation to reduce foreclosures by special forbearance, modifications, so that you work with the borrower to make sure that they do not get foreclosed. That is why if you have a delinquency rate of 10.9 percent, but yet a foreclosure rate of less than 1 percent, you have 9 percent that may be delinquent, but you are working with them so that they can stay in the home. That is one of the keys about FHA is their goal is to keep them in the home, not take it. So that is a key component of this program.

The other part, as she stated, there is this counseling after the fact. If there is some difficulty, then the lender can work with the borrower through their counseling agency to help them with what we call post-purchase counseling if there are difficulties after the loan has been closed.

Mr. CLEAVER. Is it automatic? Will the homeowner automatically be contacted, advised of the counseling service?

Mr. PETRIE. It is currently voluntary, but you have to understand that if borrowers within FHA develop too high of a foreclosure rate, they go up on their credit watch and they then can be removed as FHA lenders. So the point would be, it is voluntary, but you would do everything you could to make sure that the person stays in the house, and therefore performs this loss mitigation. So it is not in the lender who does FHA loans best interest to have high foreclosure rates because their Credit Watch score then goes up and then HUD can then take them out of the program.

Mr. CLEAVER. Thank you.

Ms. BOWDLER. I was just going to piggyback on Mr. Petrie's comments and say that is why NCLR also recommended that the product only be offered through the FHA-approved lenders who are high performers in the Credit Watch program.

Mr. TIBERI. Thank you, Mr. Cleaver.

Ms. Bowdler, just to follow up a bit on your concern about no equity in the house. Would you have an equal concern if you did have equity, but the value of the home was actually lower than what the mortgage of the home was?

Ms. BOWDLER. Right. I think if I understand the scenario that you are talking about, it is that if the true value of the home is, for example, at $100,000, but it was appraised at maybe $120,000, and your mortgage then reflects that amount. I would be equally concerned about that kind of situation, as I think most people would. I know that inflated appraisals are an issue in a lot of communities.

Mr. TIBERI. Thank you.

Mr. Newman, you mentioned in your testimony about the credit score. Do you all apply that to your home borrowers?

Mr. NEWMAN. No, we do not. It primarily goes back to my earlier comment that we depend on the lender. They do the qualification of the borrower and their credit-readiness and their ability to get into a home. So we do not put it on there. We depend tremendously on the lender.

Going back to your other question, we would not support that either, the person going into the home with a value that is higher or a mortgage or a price that is higher than the actual value of the home. We do not support that.

Mr. TIBERI. Okay. Do you have any program that tracks the borrowers that you help, the homebuyers that you help, to find out what percentage of them after 2 years or 3 years or whatever number of years are still in their home? Do you any kind of follow-up with people you put in the homes?

Mr. NEWMAN. No. We have attempted to do that, primarily through working with FHA and with HUD to get some of that data. Some of the recent reports that were done, one of the things

that were challenged about it was their inability to collect the data and to break it down in an appropriate manner.

So that is why I mentioned earlier that we would look forward to being able to work with the new Commissioner to see if there is a way that we can actually get that data, parse it out, and be able to do that kind of analysis, to really be able to see how we do. Because as much as I support the downpayment assistance industry, I also know that we at AmeriDream do a lot more than a number of our colleagues in terms of loss mitigation and homebuyer counseling. They stay in touch with us and we stay in touch with them quite often.

Mr. TIBERI. But you do not do homebuyer counseling for every homebuyer, do you?

Mr. NEWMAN. No.

Mr. TIBERI. Why is that?

Mr. NEWMAN. Again, it is one of those things where the lender, we really depend on the lender. We make it available. We have it online. We also do workshops throughout the country. Anyone who does homebuyer education, and I really have to echo something that Mr. Petrie said, homebuyer education to a lot of people, as valuable as it is, is seen as an unnecessary obstacle even by the buyers themselves. So we may make available online to individuals in English and Spanish. We may have classes available free of charge, English and Spanish, in the various communities, but they do not attend.

Giving up 4 hours or 8 hours to do a homebuyer education class that is not required by the lender or even the realtor is seen as an unnecessary step. I think every lender would be able to say the same thing, that sometimes if one lender says, I have to do it; and the other lender say, no you don't; most likely that buyer is going to go with the lender that does not make that additional step in the process. We have been challenged with that.

So we have made it available online and in person, but we really depend on the lender to qualify and to make a determination if that person actually needs it and it is an available source there if that person actually needs the homebuyer education.

Mr. TIBERI. Mr. Petrie?

Mr. PETRIE. I would just like to make one comment to kind of clarify something that Mr. Newman stated earlier when he pointed out the various players that are involved in this, the homebuilder, the appraiser and the lender. It is to me disingenuous when you create the rules for a game that people then play, and it has perverse effects, and say I am not responsible for those perverse results. The rules of the game can be changed to correct all of that if they want to do that. I think you are trying to with this legislation, and we support you with that.

So we think that those rules could be changed if they wanted to, which may change some of those perverse effects, and we would be supportive if they would change the rules. But to stand back and say, we are not the ones doing it; it is the lender, the appraiser, the home builder; I think that is disingenuous when you have created the box by which they are playing.

Thank you.

Mr. TIBERI. I appreciate that.

Mr. Newman, because I was going to have a follow-up, go ahead.

Mr. NEWMAN. I would more than welcome finding out and working with Mr. Petrie, as well as anyone else, to find out when they talk about making the rules of the game.

Mr. TIBERI. I was going to follow up on that. Thank you for bringing that up.

The study that I talked about is an Ohio study that a major newspaper is working on. If it should come out in that study that, and I am not pointing to AmeriDream because obviously there are dozens of nonprofits around the country, dozens in Ohio actually, but if it should come out in the study that the high foreclosure rate is directly linked to nonprofit activity, do you think it is an obligation of this committee and this Congress to put some rules and regulations into effect?

Let me give you an example from what a reporter told me, that she was working on that a homebuilder had told her in Ohio that they, in the first-time homebuyer market, are provided an opportunity to work with low-income, first-time homebuyers and essentially are providing the downpayments through nonprofits. But the fact of the matter is, their home prices are going up. So the point that I made before with respect to my neighbor who increased the cost of their home in exchange for downpayment assistance through a nonprofit, is happening not only with sellers, but is happening with homebuilders as well.

Essentially, the homebuilders have a gun to their head because they have a buyer who is coming with a gift program in hand to the homebuilder. So one of the reasons why I have had homebuilders in Ohio support my program is because they essentially say, let's take out the middleperson right now; the government is on the hook in the end for the foreclosures. You all, Members of Congress, are in charge of FHA, so why don't you just tighten the program?

We have the same goal in mind. You all could do that, in a sense, I think is what Mr. Petrie is saying, because you control the gift, in essence. You are the ones that are making it possible for the buyer to get into a home through the gift program because the seller cannot do it directly to the buyer, nor can the homebuilder do it directly to the buyer, unless FHA does it through a zero-down program.

I think that is what Mr. Petrie was getting to. If this report comes out and says that the high delinquency rate is tied to nonprofits, do you all have an obligation as the nonprofit industry to tighten the rules and regulations by which you all interact with appraisers, homebuilders and lenders?

Mr. NEWMAN. I am going to get to that answer in a second, but I have to start off by, when we met, as you mentioned, and also in Ann Ashburn's testimony last year, one of the things that we put in our testimony was to seek a public-private partnership with HUD to address a number of the issues that were there. We made follow-up letters and follow-up phone calls on that because we recognized that there are some of those limitations, some of those challenges.

Quite candidly, if we as an entity, meaning AmeriDream, and I need to speak specifically about AmeriDream, were to put a lot of

the safeguards that we can talk about that probably should be there, homebuyer education, most of the people we serve are first-time homebuyers. I, on the record, say that homebuyer education is a critical component; loss mitigation services so that they know there is a place for them to go to, that if they run into some trouble making a payment, that there is a place for them to call, and that nonprofit is equipped and ready to be able to do that.

We recognize that if we are going to help get people in to homes, we need to prepare them, as well as to help them stay in the homes. But if AmeriDream were to do that in and of itself, by itself, and no other downpayment assistance provider did that, the lenders would not use AmeriDream because putting those requirements on there would become friction in the process, and they would go to another downpayment provider who had no friction.

So now I get to the answer is, if that is the case, and we recognize that reality, we seek to work with HUD to put to put in the right type of relationship and the right type of rules of the game that is across the board and is not just for one entity. In the same way that one lender would not just want to say, I am only going to do this deal, this transaction, with homebuyer education, knowing that the broker or the lender next door does not require it, they are putting themselves at a significant disadvantage.

So the reality is, we know that there are issues and we know that there are problems. We have reached out on a number of occasions to try to work with the industry, to try to work with HUD and FHA to address some of those concerns. I would hope that they can be addressed within HUD and FHA without having to come to the subcommittee. That was our appeal and that is our goal. It would be the MBA, HUD, and the nonprofit organizations sitting down together to come to a viable solution that helps low-income homebuyers get in their home and stay in their home.

Mr. TIBERI. Yes?

Ms. BOWDLER. I just wanted to take an opportunity to stick up for the counseling process just a little bit.

Mr. TIBERI. You do not have to with me. It is in the bill, required in the bill.

[Laughter.]

That is why I argue that this program is actually going to be stronger than the 3 percent down program.

Ms. BOWDLER. Housing counseling really is not a hurdle to the process. I just want to give you an example of how this regularly plays out. One of our groups that works in Falls Church has been on a committee in Virginia. What happens is, a client comes in to see them; they sit down and see them face to face, and assess their situation. If they are mortgage-ready, then that initial interview may be anywhere between 1 and 2 hours. They walk them through the process; they explain everything they need to know; and then they are done.

When it takes more time is if a client is in fact not mortgage-ready. Then a family is faced with a decision: Do I want to work through a counseling process or do I want to go get a less-than-quality product that will put me in a home right now? So that is the only time that it could potentially slow down a process, is if a client has a lot of issues.

I just wanted to point out also that that is why your legislation is very smart and intuitive to put individual counseling into the bill because it is much quicker. It is going to help a client correctly identify their situation, if this product is for them, and it is going to do it a lot quicker, as opposed to group classes which may be offered once a quarter. They may take place over several weeks and are not as effective.

Mr. TIBERI. I appreciate that. Just a comment in terms of downpayment being important. I know we all come from different communities. In Columbus, Ohio, which is the largest city in Ohio, the Columbus Urban League puts on a yearly home expo for first-time homebuyers, trying to promote homeownership. Year after year, their number one issue, barrier to homeownership, is lack of a downpayment.

So while there are other issues, clearly in my community the downpayment is a significant problem, which has led to quite a bit of competition within the nonprofit community, not just AmeriDream and Nehemiah, but a number of others who are pretty active in Central Ohio.

I appreciate everyone being here today.

You look like, Mr. Shear, that you have a comment? Okay. You looked like you were poised to say something.

Thank you all for coming today. This is an important issue. As I said earlier, I hope that we all can work together to promote something that we are all concerned about, and that is higher homeownership and protection for taxpayers at the same time.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place the responses in the record.

With that, this hearing is adjourned.

[Whereupon, at 11:47 a.m., the subcommittee was adjourned.]

A P P E N D I X

June 30, 2005

Opening Statement
Chairman Michael G. Oxley
Financial Services Committee

Subcommittee on Housing and Community Opportunity
H.R. 3043, the Zero Downpayment Pilot Act of 2005

June 30, 2005

Mr. Chairman, Americans place a high value on homeownership, and that is why this Committee has remained focused on removing the barriers that prevent families from owning their own homes. During the 108th Congress, this committee was instrumental in the enactment of the American Dream Downpayment Act to provide $200 million in downpayment assistance to first-time homebuyers. Today, we are here to discuss another important piece of legislation, H.R. 3043, the Zero Down Payment Pilot Act of 2005, which will eliminate the down payment requirement for families and individuals who buy homes with FHA-insured mortgages.

Today, we enjoy an impressive homeownership rate of 69 percent, yet minority homeownership rates are only slightly below 50 percent. H.R. 3043 will go a long way to helping us close the minority homeownership gap.

Studies show that the single biggest obstacle to homeownership for most families is the inability to come up with enough cash to meet downpayment and closing costs. Minority families in particular are burdened by high downpayment requirements.

This new Zero Downpayment program will be available to first-time homebuyers that meet FHA's underwriting requirements and who could easily afford monthly payments, but have not had the opportunity to save for downpayments.

FHA loans typically require a minimum downpayment of three percent. In addition, FHA underwriting rules allow applicants to have higher household debt ratios: monthly housing payments can be as high as 29 percent of monthly household income, and total monthly debt can go to 41 percent of monthly household income. Both these standards are more generous than most lenders and the prime market now allow.

I understand that this legislation incorporates ideas and concerns raised during last year's March 24, 2005 hearing and June 3, 2004 Committee markup. As a result, this proposal is a pilot program, limited to 50,000 mortgages and will sunset in 2010. Moreover, it incorporates several safeguards, to ensure adequate underwriting as well as protection of the FHA's Mutual Mortgage Insurance Fund that were developed during last year's markup. It appears that these changes will make the pilot program responsive to concerns that without adequate safeguards, zero downpayment requirements will lead to increased foreclosures.

This is an important initiative and I look forward to working with Chairman Ney, Congressmen Tiberi and Scott to enact this important new initiative.

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Opening Statement of the Honorable Bob Ney
Chairman, Subcommittee on Housing and Community Opportunity

Hearing on

"H.R. 3043, the Zero Downpayment Pilot Program Act of 2005"

Thursday, June 30, 2005

This morning the Subcommittee meets to discuss Congressmen Pat Tiberi and David Scott's legislation to create more homeownership opportunities for first-time homebuyers. Re-introduced last week, H.R. 3043 would eliminate the downpayment requirement for families and individuals who buy homes with FHA-insured mortgages.

Theoretically, downpayment requirements were established to assure the lender that a borrower would be less likely to default or risk foreclosure on a home if there was some personal investment stake. Before the invention of automated or computerized underwriting to determine credit scores, lenders believed that downpayments were one of the best techniques to assess the creditworthiness of a potential borrower.

After hearings conducted on March 24, 2004 and a Full Committee markup on June 3, 2004 on the predecessor bill, H.R. 3043 incorporates the 2004 reported bill as well as key revisions that would establish the bill as a pilot program, limit the pilot to 50,000 loans, and sunset the program in 2010.

Today's hearing will allow us to continue our discussions from the previous Congress as to whether this proposal would increase defaults and foreclosures for FHA-related mortgages, placing the Federal government at a higher liability. The new legislation incorporates several safeguards that protect FHA's Mutual Mortgage Insurance Fund and enhance provisions developed during last year's markup. It appears these changes will help make the pilot program responsive to concerns that without adequate safeguards, zero downpayment requirements will lead to increased foreclosures. However, critics continue to state that it is unclear whether removing downpayment requirements could be a sound underwriting decision and whether borrowers without downpayment contributions from their own resources would pose a greater credit risk.

As we debated Cong. Tiberi and Cong. Scott's Zero Downpayment proposal last year, we learned that the biggest obstacle to homeownership for most families is the inability to come up with enough cash to meet down payment and closing costs. Minority families in particular are burdened by high down payment requirements. As of the first quarter of 2005, the racial divide in homeownership remains wide, with 76 percent of white households owning their own home, compared with 48.8 percent of African American households and 49.7 percent of Hispanic households.

Lagging minority homeownership rates are a serious concern. Minority households are expected to account for two-thirds of household growth over the coming decade.

As we continue our debate on legislation such as Zero Downpayment and other homeownership initiatives, improving the ability of such households to make the transition to homeownership will be an especially important test of the nation's capacity to create economic opportunity for minorities and immigrants and to build strong, stable communities.

This is an important piece of legislation before our Subcommittee today, and I look forward to working with Congressmen Tiberi and Scott as this bill works its way through the legislative process.

Statement by Rep. Tiberi for the Housing Subcommittee hearing on H.R. 3043, the Zero Down Payment Pilot Program Act of 2005

On June 23, 2005 Congressman David Scott and I introduced H.R. 3043, the Zero Down Payment Pilot Program Act of 2005. This legislation, administered as a pilot program and limited to 50,000 loans, will eliminate the down payment requirement for families and individuals who purchase homes with FHA insured mortgage.

Today we enjoy an impressive homeownership rate of nearly 70% however minority homeownership rates continue to be 25% lower than those for non-minorities.

The Zero Down Payment Mortgage would be available for first time homebuyers that meet FHA's underwriting requirements, but because of their circumstances have not had the opportunity to save for a down payment. This legislation does not lower the credit standards for FHA borrowers; the same standards used for all borrowers will be used for those who participate in the Zero Down Payment program.

Those who qualify for this program will be charged a slightly higher premium on their mortgage. For example, for a $100,000 mortgage, a Zero Down Payment borrower would pay approximately $50 more per month than a regular borrower. The higher premium that is charged will cover the cost of the program, meaning no additional cost to taxpayers.

This legislation also includes additional safeguards to assure its fiscal responsibility and guard against defaults. Those who wish to participate must receive pre-purchase counseling and have the option to request that a housing counseling representative contact them should they default on their loan. Both of these measures are something that no other FHA program offers. Additionally, should the default rate reach an unacceptable level the program will be automatically shut down.

In comparison to private programs which offer similar services, consumers in this program will receive a more complete overview of the product they are purchasing along with information on the responsibilities of being a homeowner. Also, with an FHA backed Zero Down Payment program such as this, I believe that those who wish to participate will have better, faster, and more accurate access to their personal financial information.

As a former realtor, I've seen first hand the benefits of home ownership. It means stability for families, and for communities. What's more, buying a home is usually a family's largest single investment. As they build equity in that home, that family is building wealth.

H.R. 3043: Zero Downpayment Pilot Program Act 2005

Submitted to:

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

Submitted by:

Janis Bowdler, Housing Policy Analyst
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NATIONAL COUNCIL OF LA RAZA
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June 30, 2005

My name is Janis Bowdler, Housing Policy Analyst for the National Council of La Raza (NCLR). As part of NCLR's Economic Mobility Initiative, I conduct research, policy analysis, advocacy, and program assistance on affordable housing issues. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. On behalf of NCLR, I am pleased to present this statement for the hearing on H.R. 3043: Zero Downpayment Act of 2005 (ZDA). NCLR is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve life opportunities for the nation's Hispanics. As the largest national Hispanic constituency-based organization in the U.S., NCLR serves all Hispanic nationality-groups in all regions of the country through a network of more than 300 affiliate community-based organizations.

NCLR has a deep interest in increasing the rate at which Latinos own and build equity in their home and thereby accumulate wealth that will provide financial stability in the years to come. Over the past two decades, NCLR has been a leader in advocating and conducting research on affordable housing issues important to the Latino community. This work focuses on issues such as asset accumulation and barriers to homeownership, access to affordable mortgage products, and programs and legislation that support fair lending. NCLR's most recent publications include *Hispanic Housing and Homeownership*, June 2004; *American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*, March 2004, prepared for the National Fair Housing Research and Policy Forum; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*, June 2005.

In addition, since 1997 NCLR has been the national intermediary designated by the Department of Housing and Urban Development (HUD) to distribute funds for housing counseling. The NCLR Homeownership Network (NHN) consists of 38 NCLR affiliates in 19 states that provide pre-purchase bilingual homeownership counseling to low-income families in predominately Latino neighborhoods. NHN counsels more than 20,000 families each year, more than 3,500 of which become homeowners. NHN has sophisticated partnerships with some of the nation's largest providers of home mortgages such as Bank of America, Countrywide, JPMorgan Chase, Washington Mutual, Wells Fargo, as well as Fannie Mae and Freddie Mac. Our extensive research and service delivery experience puts us in a unique position to comment on the Zero Downpayment Act.

Latino Homeownership

Increasing Latino homeownership is critical to the financial security of Latino families and the economic stability of the broader community. While Hispanic homeownership still falls behind that of Whites according to HUD's most recent statistics (48% versus 76%, respectively), Hispanic families are entering the mortgage market in record numbers. Between 1993 and 2003, the number of Hispanic households grew by 92% while the number of Hispanic homeowners grew by 96%. For most American families, a home is their primary asset and homeownership represents their single greatest wealth-building vehicle; this allows households to leverage equity to send children to college or start a business, and to build strong and stable communities. Unfortunately, the Latino homeownership rate lags behind that of Whites by 28 percentage points, and the gap is no longer decreasing at a rapid rate. Low homeownership rates are the

primary factor contributing to the 27-to-1 wealth gap between Whites and Latinos. Latino families face a number of barriers when attempting to purchase their first home, including:

- **Lack of information:** Many first-time Hispanic homebuyers are also first-generation homebuyers, and many have low levels of interaction with mainstream financial institutions. In addition, historically low levels of advertising and outreach from the financial services sector to low- and moderate-income Latino families have contributed to the lack of information and access to affordable mortgage products.

- **Systemic Barriers:** Many Hispanic households have "thin" or no credit histories, sometimes due to a preference not to carry debt, which often results in artificially low credit scores. Due to a "one-size-fits-all" approach to financial and credit-scoring systems, an otherwise mortgage-ready family may be unable to qualify for a loan, or may be paying too much for their financing.

- **Affordability:** Although the Hispanic population is growing in many areas of the country, more than one-third live in California and New York, two of the least affordable states in which to own a home, according to the National Low Income Housing Coalition. More than two in five Hispanic households, and more than a third of Hispanic owners, dedicate more than 30% of their income to housing, the federally-recommended standard for affordability.

- **Market Failure:** Many financial institutions are experimenting with pilot products and innovative underwriting criteria; however, more should be done to meet the needs of a dynamic marketplace. Most institutions use a passive product-driven outreach system that assumes that the same product is sufficient to meet the needs of all or most buyers, rather than an assertive market-oriented approach that would value different credit behaviors and use innovative underwriting criteria (such as nontraditional credit). Using such an approach, financial institutions would create products that more adequately serve a dynamic market.

Positive Steps Toward Increasing Latino Homeownership

The federal government created the Federal Housing Administration (FHA) in 1934 to insure the mortgages of families with solid jobs, but without the cash to make the 20% downpayment that was required at the time; now, for example, many families have the opportunity to purchase a home with a 3% downpayment. FHA has been crucial to making homeownership more affordable for many families who may have otherwise gone unserved by mainstream mortgage lenders. One in five Hispanic families with a mortgage in 2003 had an FHA-insured mortgage. While the private market has evolved to offer more affordable products, FHA still serves low- and moderate-income families that may not have other mortgage-financing options. However, in 2004 FHA loans were more than five times as likely as prime loans to be in foreclosure. Moreover, many consumer advocates and municipalities have criticized FHA products as being vulnerable to abuse by bad players in the marketplace whose unethical practices have robbed families of their hard-earned equity and left them vulnerable to default and foreclosure. On average, a family loses $7,200 in net worth during a foreclosure, and the community

stakeholders, including the lender, stand to lose approximately $73,300 per FHA foreclosure (according to the National Multifamily Housing Council and the National Apartment Association). As a public agency, FHA has a responsibility to see that their products promote the best interest of the consumer and the American public.

NCLR applauds this committee's ongoing commitment to fair and affordable homeownership. In the previous Congress, this committee increased the FHA multifamily loan limits in "hot markets" throughout the country, including many cities with high Latino populations. The FHA Multifamily Loan Limit Adjustment Act of 2003 will level the playing field for those urban areas where high land costs drive housing prices beyond what many families can afford. In addition, the committee has shown strong support for increased funding and capacity for housing counseling. Housing counseling is a powerful tool that effectively moves low- and moderate-income Latino families into homeownership. NCLR's NHN counseling agencies, for example, provide bilingual pre-purchase counseling services to families in low-income Latino neighborhoods and spend three months to three years helping families become financially-secure homeowners. These agencies are a testament to the value of homeownership counseling. In 2004, NHN organizations counseled 24,000 families and helped more than 3,500 become homeowners (which count only those closed through the NHN system); 63% of NHN clients earn less than 50% of Area Median Income (AMI), and another 27% earn between 50% and 80% AMI. Families that became homeowners through the NHN had a 6% interest rate on average.

Zero Downpayment Act

NCLR commends Congressman Tiberi on the improvements in the Zero Downpayment Act over the version introduced in the previous session. One hundred percent financing is financially risky for many families. In the case of FHA-insured products, many borrowers are likely to find themselves owing more on their home than its total appraised value. This situation, often called an "upside down mortgage," would be devastating in the event of an unforeseen event such as job loss or divorce, which are the more common reasons for default. The addition of pre-purchase and default counseling provisions to the more recent version of the legislation will help vulnerable families make educated decisions about this product. Pre-purchase counseling has been shown to decrease the risk of 60-day delinquency, which translates into a potential savings to taxpayers (according to research conducted by Freddie Mac). That said, we, along with other advocates, believe that the bill could use more improvements. NCLR makes the following recommendations to ensure that the legislation achieves its objective of effectively providing fair and affordable financing to low- and moderate-income families:

- **Ensure adequate resources for housing counseling agencies.** Housing counseling agencies provide the mortgage industry with a valuable service by preparing families for responsible homeownership. H.R. 3043 should clearly state that housing counseling agencies can be compensated based on the value of the services they provide to a financial institution. Given the number of families who would need pre- and post-purchase counseling under this legislation, housing counseling agencies must be able to generate consistent fee-based revenue to increase capacity and meet the market demand. This, however, does not negate the need for HUD funding. Currently, HUD recommends that funding for housing counseling agencies not exceed 20% of the program budget.

These funds are critical to creating new counseling programs and strengthening existing ones.

- **Ensure timely access to counseling.** H.R. 3043 requires that counseling be received before application for a ZDA loan. It is critical that the HUD-certified counseling program be **completed** before the application date of the ZDA. This ensures that the borrower has had enough time to receive counseling and make the decision that is best for their family without being rushed or pressured by the lender or mortgage broker. This and the above recommendation will help counseling agencies maintain the viability and quality of the services delivered, which is essential to the thousands of families who rely on them.

- **Prevent unethical lending practices.** The committee can curb the potential for abuse by allowing this product to be offered only by FHA-approved lenders with the highest ratings under HUD's *Credit Watch* program.

Conclusion

Affordable mortgage products with innovative underwriting criteria are important for increasing sustainable Hispanic homeownership. As the committee considers other approaches to affordable home financing, NCLR makes the following recommendations:

- **Reinstate mandatory counseling for FHA borrowers.** Rising foreclosure rates and reports of abuse by FHA lenders demonstrate the need that FHA borrowers have to receive pre-purchase housing counseling. Counseling should be provided by HUD-approved counseling agencies. Moreover, counseling agencies should be compensated based on the value of the work they provide to financial institutions and FHA.

- **Graduate FHA-insurance premiums.** Reward timely payments and reduction of risk, demonstrated through pre- and post-counseling or on-time payments for the first 24 months of the loan, by gradually lowering the cost of FHA insurance.

- **Create flexible products.** FHA could better assist first-time homebuyers by offering a subordinate second mortgage (often called a "soft-second") that would buy down the cost of the loan without an excessively risky Loan-To-Value rate.

NCLR thanks the committee for the opportunity to share our views on the legislation.

STATEMENT OF BRIAN D. MONTGOMERY

Assistant Secretary for Housing – Federal Housing Commissioner

U.S. Department of Housing and Urban Development

Chairman Ney, Ranking Member Waters, and distinguished Members of the Subcommittee, thank you for the opportunity to submit this statement for the record, as you hold today's hearing on Representative Tiberi's new Zero Down legislation, H.R. 3043. As you know, the Administration has proposed, for the second year, legislation for a new mortgage insurance program under the National Housing Act, the "Zero Down Payment" program, which is specifically designed to help first-time homebuyers purchase a home. My comments will focus on the Administration proposal and the importance of a new "Zero Down" program.

It is my strong belief that this new product can be invaluable for those hard-working Americans who have steady incomes, but lack the savings to come up with a down payment on a home. This "Zero Down" product can provide these people who are at the doorstep of homeownership with an affordable means of achieving this dream. Zero Down can create first-time homebuyers in a way that is less risky, and most importantly, cheaper than the alternatives available to them now in the subprime market.

Under this new program, the Federal Housing Administration (FHA) will insure 100 percent of the cost to acquire the home, allowing first-time homebuyers to finance all of the mortgage as well as all of the closing costs. Potential homebuyers would not have to make the minimum downpayment of three percent that is required in our chief single-family insurance program, Section 203(b).

I want to emphasize the value of this FHA product, particularly when compared to subprime alternatives. Briefly, I will summarize the unique role FHA has played, and continues to play, in serving as a haven for potential homebuyers, particularly first-time homebuyers.

FHA's Contribution to the Ownership Society

Since 1934, FHA has been instrumental in creating the society of ownership, providing families with a viable and reasonable means to achieve wealth through homeownership. The intent of Zero Down takes this concept one step further. It provides a safer and more affordable way for families with little savings to realize their dream of homeownership and accumulating wealth without the corrosive effects of the expensive terms and conditions that are prevalent in the subprime market. There are far too many families steered towards the subprime market that are paying more for their homes and financing than they should.

FHA's Unique Consumer Protections

FHA, by its very nature, protects consumers. We regulate the lenders and appraisers that participate in our programs; we regulate the fees and charges associated with buying a home; and we help keep families in their homes with our very aggressive loss mitigation strategies. It is important to underscore our successes in loss mitigation and note that in 2004 nearly 55% of all FHA homeowners that experienced serious

difficulties in making their mortgage payments were able to remain in their homes and retain ownership of it. For 2005, that percentage jumps to 60%. It is because of these consumer protections that FHA's Zero Down program is a more affordable and practical financing option than the alternatives in the subprime market.

Studies have consistently shown that the single biggest obstacle to homeownership for most families is the inability to come up with enough cash to meet down payment and closing costs. Many potential homebuyers pay the equivalent of a monthly mortgage in rent, but are unable to save toward a down payment on a home purchase. Minority families in particular are burdened by high down payment requirements.

This new FHA mortgage product would be structured to assist those creditworthy but cash poor working individuals and families who have been excluded from purchasing their first home. Most of these families can afford a monthly payment, but lack the money for a downpayment and closing costs.

HUD has designed this program to minimize defaults and to protect the Mutual Mortgage Insurance Fund. FHA has made conservative financial assumptions regarding this program. In order to cover the costs of the program, families who qualify for the Zero Down Payment Plan would be charged a modestly higher insurance premium on their home loan than they would in the existing 203(b) program. Essentially, the upfront premium would be set to ensure that the MMI Fund remains actuarially sound.

Borrowers would be held to the same underwriting guidelines as those who apply for FHA's standard three percent downpayment mortgage. They must meet the same payment-to-income and debt-to-income ratios and the same credit standards. To minimize risk to MMI Fund, our new FHA TOTAL (Technology Open To Approved Lenders) Mortgage Scorecard must also be used to evaluate the overall credit worthiness of borrowers. Lenders in conjunction with an automated underwriting system to underwrite an FHA-insured loan electronically utilize this mortgage scorecard.

TOTAL Scorecard allows FHA lenders to better predict which borrowers are good risks and also identify those that are bad risks. In developing FHA's electronic scorecard, HUD took into account studies that have shown that creditworthiness is a better predictor of the homeowner's ability to pay mortgage payments than the amount of the downpayment. By requiring that the Zero Down Payment Program loans be risk-assessed by TOTAL Scorecard, FHA will immediately be able to determine the perceived risk of each loan.

To further minimize risk, the proposal for the Zero Down Payment Program includes a housing counseling requirement. Housing counseling has proven to be an extremely important element in the purchase of a home. Reliable quantitative research demonstrates that housing counseling can be very effective in reducing mortgage delinquency. By limiting delinquency and foreclosure, housing counseling is a cost-

effective way to reduce the FHA's exposure to risk while contributing to the growth and stability of communities across the country.

In summary, the Administration and the Department are firmly committed to helping more American families achieve the dream of homeownership. We believe the Zero Down Payment Program will be a financially sound and effective means to do so and will compliment other efforts that are currently underway to help hard working families become homeowners using financing that is safer and more affordable than the subprime market.

This concludes my statement, Mr. Chairman. I thank the Committee for the opportunity to submit this statement.

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Testimony of Robert Newman
Executive Vice President and Chief Operating Officer
AmeriDream, Inc.

H.R. 3043,
The Zero Downpayment Pilot Program Act of 2005

Testimony before the Subcommittee on Housing and Community Opportunity
United States House of Representatives
June 30, 2005

Doing things right for America's homebuyers.

Good morning, Chairman Ney, Ranking Member Waters, and distinguished Members of the Subcommittee, thank you for this opportunity to testify regarding "H.R. 3043, The Zero Downpayment Pilot Program Act of 2005"

My name is Robert Newman and I am the Executive Vice President and Chief Operating Officer of AmeriDream, Inc., the nation's leader in providing affordable housing opportunities. Let me begin by providing some important background information about AmeriDream that will give the Subcommittee a better understanding of our role in helping homebuyers achieve the American Dream of homeownership.

AmeriDream's mission is to expand affordable housing opportunities for underserved groups and promote the value of homeownership as the foundation for building strong communities and individual prosperity. The work of AmeriDream began in February 1999 to help reduce the government's burden of increasing homeownership to everyone, especially low- to moderate-income homebuyers. Since our inception, we have helped more than 160,000 low- to moderate-income individuals and families become homeowners and have given more than $500 million in down payment gifts to homebuyers nationwide, which translates into more than $15 billion in home sales. We have provided homebuyer education to over 6,000 people; counseled over 500 homeowners seeking help with loss mitigation; invested over $12 million in community redevelopment projects; given over $2 million in funding to other nonprofits to support their missions; and, have led the way for non-profit organizations by doing things right for America's homebuyers. All our services are provided in both English and Spanish. *It is important to note that all of these services have been provided free of charge to homebuyers and have not used government funding or taxpayer dollars.*

Our most successful program is our Downpayment Gift Program, which is designed to assist individuals and families overcome the greatest hurdle to homeownership: the down payment. We do this by providing gift funds averaging 3-6% of a home's purchase price for a down payment or closing costs. Potential low- to moderate-income homebuyers must meet all lender qualifications for a mortgage and need to purchase their home from a builder or seller who has enrolled a home in the AmeriDream program. It is through this program that we gained significant expertise in serving the low- to moderate-income homebuyers -- the same population that is served through FHA.

Last year, AmeriDream lent its expertise to help shape the Zero Downpayment Act. Ann Ashburn, AmeriDream's President & CEO, provided testimony to this Subcommittee and noted several observations and suggested refinements to the bill. We worked with the Subcommittee to provide input to help perfect the bill. We drew upon our experience and knowledge and set forth that which would be in the best interest of today's homebuyers. We commend the Subcommittee for listening to our input, drawing upon our expertise and incorporating our comments into the bill we have before us today, H.R. 3043.

It is only appropriate that I acknowledge some of these improvements. First, we are pleased that homebuyer education is now a requirement for homebuyers participating in the Zero Down

program. We are well aware of the significant impact homebuyer education has on loan performance. In addition, we also appreciate the required disclosures regarding the homebuyers' alternatives to the Zero Down program as well as disclosing the increased costs associated with the use of this program.

H.R. 3043 is also greatly improved by use of HUD's TOTAL scoring systems in the processing and approving of borrower applications for participation in the Zero Down program. Automated underwriting models and similar technological advances hold tremendous promise in controlling the credit quality of loans by ensuring that all relevant risk factors are considered.

Finally, we are appreciative of your recognition that much is not known about how this program will work and the real impacts it can have on the homebuying and homeownership experience. Implementing the Zero Down program as a demonstration or pilot program advances this important policy objective in a way that both reduces potential risks and enhances the program's likelihood of success.

In that same spirit of providing ongoing input to the Subcommittee, we would respectfully propose three additional refinements to the bill. It is our hope that through these refinements the Subcommittee will enact a bill that is good for the people, good for the community, good for the country, and good for the government. With all of us working hand-in-hand, we can create and secure a viable program for which people typically locked out of homeownership can use for a place called home.

First, we encourage the Subcommittee to seek appropriate ways to leverage the substantial experience and resources of charitable down payment gift providers. We believe this can be accomplished by recognizing in H.R. 3043 that nonprofit down payment assistance providers are structured to reduce the burden of governments' limited resources and are a viable option to the Zero Down for homebuyers who need down payment assistance but do not choose the Zero Down program.

AmeriDream has created a place called home for more than 160,000 individuals and families. In our testimony last year we acknowledged that while there are considerable, though limited, resources of the federal government to bear on the challenge of high down payment costs, we respectfully suggest that Members not overlook the integral role that non-profit organizations such as AmeriDream can continue to play in helping low- to moderate-income homebuyers achieve the dream of homeownership. In our view, the goal of increasing homeownership is too important an objective to ignore the long experience and deep expertise of reputable charitable providers: the best solution is for us to work together.

While the federal government has recently begun to propose important initiatives to help low- to moderate-income homebuyers overcome the barrier of high down payments, non-profit organizations have been meeting this challenge successfully for years. Mr. Chairman, as an example, from the time we sat before you last year to now, AmeriDream alone has helped an additional 30,000 homebuyers become homeowners. And, we continue to help hard-working

families achieve and keep the American dream today through our full range of homeownership-related services, all without government funding, taxpayer dollars, or additional potential risks to homebuyers or the FHA insurance fund. As we have since 1999, AmeriDream stands ready to work with this Subcommittee, HUD and the Administration, and all others committed to homeownership in exploring how the charitable sector can most productively assist the government's efforts.

Second, we suggest that H.R. 3043 ensure homebuyers the option to use non-profit down payment assistance programs to offset the fees associated with participating in the Zero Down program.

AmeriDream strongly supports the concept of removing the down payment barrier that prevents many credit-worthy families from owning their own homes. FHA has a clear public purpose to reach segments of the population currently overlooked or underserved by the conventional mortgage market. This must be done in a manner that does not put unfair burdens on the low to moderate income homebuyer.

Through the current proposal, families will enter homeownership with a 100-105% loan-to-value. This would place families in the position of owing more than the house is actually worth, thus providing them with zero to negative equity in the house. In addition, the family will also have a higher interest rate and pay additional costs, all adding up to a higher monthly mortgage payment, in turn, reducing low- to moderate-income wage earners' disposable income to meet other family needs.

It is also important to recognize that the additional money paid monthly by these homeowners has increased from the amount they would have paid under last year's bill. According to the Congressional Budget Office, the current bill would cost around $38 million over 5 years. You may recall that last year's score was over $560 million. CBO has indicated that the difference is made up by charging participants higher interest: 0.75% for the first five years (which is up from 0.55%) and 0.50% for the remainder of the loan until it reaches a 78% LTV. While we recognize the current bill requires housing counselors to disclose the higher fees, it is important that home buyers know that downpayment assistance providers are a resource for assistance in paying these fees.

Third, we recommend that the Zero Down program homebuyers have a 700 credit score.

The amount of equity that a family has in its home has been shown to be one of the principle drivers of mortgage default. The vast majority of borrowers do not default. Borrowers are much more likely to continue with their mortgage payments if they have equity in their homes even if the borrowers encounter financial hardship due to a job loss, a divorce, or a serious illness. Borrowers with positive equity can sell or refinance their homes and generate cash. In comparison, cash-strapped borrowers who owe more than their homes are worth are much more likely to simply turn in the keys and let the loan foreclose.

Given this reality, most 100% no down payment programs in the conventional market require that the borrower have a relatively strong credit score. This is because they know that there is risk for families with no equity and even greater risk with negative equity in a home. To be consistent and to coincide with FHA's goals of fostering successful homeownership, we propose that the FHA zero down proposal should require borrowers to have a 700 credit score. Research has shown that mortgages that are weak on one dimension may be relatively good credit risks, but mortgages that are weak on a number of different dimensions are far less likely to perform. As a result, credit offsets limit the risk of the loans and increase the opportunity for successful homeownership.

The refinements we propose are intended to enhance H.R. 3043's ability to increase successful homeownership. They are offered in the spirit of partnership and are supported by the experience and accomplishment of having successfully enabled more than 160,000 families in this country to attain the American Dream of homeownership.

Mr. Chairman, I hope my comments and suggestions make clear to you and your distinguished colleagues that we praise your efforts in fostering homeownership for the low- to moderate-income families of America. I also hope that under your leadership and direction, our suggested refinements will be included in H.R. 3043 as you consider what is best for those among us who heretofore have had the greatest challenges in gaining successful homeownership.

Thank you for your time and I welcome any questions you may have for me.

STATEMENT

of

Michael F. Petrie

on

H.R. 3043

"Zero Downpayment Pilot Program Act of 2005"

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

June 30, 2005

Good morning, and thank you Mr. Chairman, for holding this hearing and inviting the Mortgage Bankers Association (MBA)[1] to share its views on H.R. 3043, the *Zero Downpayment Pilot Program Act of 2005*, introduced by Congressmen Tiberi and Scott on June 23, 2005. My name is Michael Petrie and I am President of P/R Mortgage & Investment Corp. (P/RMIC), Indianapolis, Indiana, Chairman of Greensfork Township State Bank, Spartanburg, Indiana, and Chairman of the MBA.

We are excited to present this testimony concerning the Federal Housing Administration (FHA) and the important role it can play in today's real estate finance system. In particular, MBA believes that FHA has the ability to offer a no downpayment home loan product that could affordably extend the opportunity of homeownership to families.

Homeownership Success

The U.S. currently enjoys one of the highest rates of homeownership it has ever seen with 69.1% of households owning their own home. This committee understands well the bedrock role that homeownership plays in the typical American family's financial health. You have heard the numerous stories of families that have benefited financially and socially from homeownership. You have read the numerous reports and studies that have validated these stories.

While FHA began this success story for the American family over 70 years ago, the private sector has continued this success story with innovations, especially over the past 15 years, in developing sophisticated credit-qualifying tools and a diverse array of mortgage products.

Over the past 15 years, tools such as Automated Underwriting Systems (AUS), risk-based pricing, and our national credit record system, have allowed mortgage lenders to better gauge risk and extend the opportunity of homeownership to more American families than ever before.

Along with the development of better tools has come the development of innovative mortgage products. These products have given the American homebuyer greater choice in meeting their financing needs. This country's high homeownership rate is a testament to the effectiveness of these tools and these mortgage products.

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[1] **The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,900 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.**

Recently there has been much attention to the growth of certain mortgage products. Some have expressed concern that lenders are extending too much credit and that these loans may pose a risk to our home finance system. Others have expressed the concern that certain products are being offered to homebuyers for whom the products are not suitable. Additionally, MBA understands that the Office of the Comptroller of the Currency is currently considering developing guidance for their regulated institutions concerning appropriate policies with regards to evaluating the risk of these new products.

To all of these concerns, MBA responds: These are good reasons as to why this country needs a strong FHA, an FHA that is empowered to pilot products and specifically why we need H.R. 3043. H.R. 3043 will allow FHA to offer sound, no downpayment mortgage financing to homebuyers with required counseling and with all the protections that go along with FHA financing. FHA is well positioned to safely offer this product at affordable terms to higher-risk borrowers. FHA's loss mitigation program can ensure that these borrowers have an array of options at their disposal after they close on their loan, should they run into trouble.

There's nothing more productive that this Congress could do this year to help focus mortgage product innovation on meeting the needs of consumers, than by passing H.R. 3043.

Changes over the past year make an FHA zero downpayment product more important

Over a year ago, MBA testified before this subcommittee in support of an FHA zero downpayment product. At that time, some in Congress, and in the industry, were critical of H.R. 3175 *The Zero Downpayment Act of 2004*, introduced by Representative Tiberi (R-OH) during the 108th Congress. Most of the concerns were addressed by the Financial Services Committee and H.R. 3043 is very similar to H.R. 3175, as reported out of committee last year.

There have been many additional changes over the past year that make an FHA zero downpayment program even more relevant today. Below are some of these changes.

- The U.S. Government Accountability Office (GAO) issued a report in February 2005 entitled *Mortgage Financing Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*. The report encourages FHA to pilot new products and encourages Congress to give FHA the authority to do so. H.R. 3043, *The Zero Downpayment Pilot Program Act of 2005* is wholly consistent with this, and other, recommendations in the report.

- On March 1, 2005, the Department of Housing and Urban Development (HUD) completed its comprehensive report on certain downpayment assistance programs currently authorized by FHA[2]. The report was commissioned by HUD's Office of Housing after several reports were issued by HUD's Office of Inspector General (HUD IG) concerning certain downpayment assistance programs where the seller provides the downpayment indirectly to the homebuyer through a 501(c)(3) corporation. The HUD IG reports found that such programs had high default rates.

  The March 1, 2005 report found that borrowers utilizing these seller-provided downpayment assistance programs share the same risk profile as those that would be served by the proposed zero downpayment program. Importantly, though, the report also found that the vast majority of the 501(c)(3) corporations that arrange these seller-provided downpayments do not include the risk mitigation features that are included in H.R. 3043. H.R. 3043 would serve these same borrowers but in a more prudent manner by:

  - Requiring pre-purchase counseling of homebuyers to help them decide whether or not the product is a good fit for them; and

  - Mandating the use of additional credit risk tools such as FHA's Technology Open To Approved Lenders (TOTAL) mortgage scorecard.

  In 2004, FHA insured 159,366 loans where a nonprofit provided a downpayment. H.R. 3043, as a pilot, contemplates insuring 50,000. MBA believes that most of the borrowers under H.R. 3043 will come from the pool of borrowers that are currently served by these downpayment programs. H.R. 3043 will, therefore, serve the same borrower type being served by FHA today, but do so with appropriate risk mitigation tools that will result in a lower default rate.

  One of the report's recommendations asserts unequivocally: "Implement the proposed zero downpayment program. Because of the incentives to raise the property sales price to cover the cost of the downpayment assistance, seller-funded DA creates an illusion of equity."[3]

  FHA and the FHA borrower will recognize a net improvement to their financial health through their use a zero downpayment loan under H.R. 3043 than under current authorized programs.

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[2] "An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations," Final Report, March 1, 2005, HUD Contract No: C-OPC-22550/M0001

[3] Ibid. page 102

- MBA's most recent National Delinquency Survey reveals that delinquencies and foreclosures of FHA loans have declined during the first quarter of 2005. This decline is consistent with the testimony of then FHA Commissioner Weicher before this committee in 2004 when he described FHA's foreclosure and delinquency rates as a "lagging economic indicator" and expected them to improve over the coming year.

- Finally, MBA understands that the Zero Downpayment Program proposal, as scored by the Congressional Budget Office (CBO) in the President's 2006 budget, is expected to have only a minimal cost over the next 5 years. We believe that CBO will have similar estimates of nominal costs when scoring H.R. 3043.

  These "costs" though, need to be put in perspective: even with a zero downpayment product, FHA's operations are still expected to continue to generate hundreds of millions of dollars for the U.S. government. This 5-year cost of H.R 3043 is likely to be comparable to the $50 million dollars that the House Appropriations Committee approved for the American Dream Downpayment Initiative for FY 2006 alone, and yet the Administration's zero downpayment program is expected to serve 150,000 homebuyers a year.

Unfortunately the Homeownership Gap has not changed over the past year

As outlined above, much has changed over the past year since the FHA Zero Downpayment Program was first proposed.

Unfortunately, some things have not changed.

While we can celebrate the U.S.'s high homeownership rate, that very same rate masks a glaring disparity: minorities have a much lower rate of homeownership than non-minorities, and low- and moderate-income families have a much lower rate of homeownership than those at or above median-income levels. This was true a year ago and, unfortunately, still remains very true today.

In the first quarter of 2005, while 76% of Non-Hispanic White households owned their own homes, only 49.3% of African-American households and 49.7% of Hispanic households owned their own homes. Additionally, while 84% of families earning more than $50,000 owned their own home, only 57% of families earning less than $50,000 owned their own home.

MBA believes these homeownership gaps are a problem.

Simply put: not all populations equally participate in the benefits of homeownership.
The gaps in homeownership rates are a result of several issues, and closing the homeownership gap will require several initiatives. H.R. 3043 deals directly with one prominent obstacle: the downpayment.

The downpayment hurdle appears to be a major obstacle for low- and moderate-income families. Several studies have identified the "wealth constraint" – that is the ability to save for a downpayment – as a major homeownership barrier for minority families. Practically by definition, the downpayment hurdle disproportionately affects low- and moderate-income families who may be able to make monthly housing payments without difficulty, but find it problematic to save for the downpayment.

MBA believes that in order to truly expand homeownership opportunities, we must overcome the downpayment challenge. We believe an FHA zero downpayment loan program is the appropriate tool for addressing this challenge.

FHA Can Do It

In the past, the amount of downpayment was considered a significant indicator of credit risk, that is, the willingness and ability of a borrower to make monthly payments on a mortgage. The benchmark was (and still is) that a 20% downpayment on a home provides lenders sufficient comfort that a borrower has the ability to handle the mortgage and provides the borrower a buffer of equity if they have to sell.

FHA began the trend of insuring mortgages with less than a 20% downpayment back in the late 1930s. Over the years, FHA has gradually, and successfully, lowered the amount of required downpayment. Today, FHA will insure a loan up to 97% of the value of a home, requiring the borrower to provide only a 3% downpayment. FHA has provided this insurance at no cost to the American taxpayer. In fact, FHA generates hundreds of millions of dollars each year for the U.S. Treasury. These funds effectively lower the deficit.

As downpayment requirements were lowered by FHA and subsequently by the private market, important advances were made in credit underwriting over the past 15 years, such as the emergence of Automated Underwriting Systems and a national credit reporting system. These advances have allowed lenders to more accurately gauge credit risk with less reliance on strict benchmarks like downpayment amounts.

Lenders have discovered (and studies have supported) that a borrower's credit profile is a more important indicator of the performance of a loan than is the amount of the downpayment. The national credit information system preserved under the Fair and Accurate Credit Transactions Act of 2003 allows lenders to efficiently access a borrower's credit information and effectively evaluate risk.

Given these facts, MBA believes it is time for FHA to address the downpayment challenge by offering a no downpayment product.

In looking to remove the downpayment as an obstacle to homeownership, MBA is not suggesting a "homeownership at all costs" strategy. Rather, we are advocating a targeted and measured attempt to remove the downpayment obstacle and close the homeownership gap among ethnic groups and economic classes.

FHA is well positioned to close the homeownership gap

FHA's single-family programs serve minorities at higher rates than the market at large. In 2003, nearly a third of all FHA borrowers were minorities, twice the rate of the conventional market. In fact, if you look at purchase loans, that is, loans that create homeowners, FHA served as many African-American and Hispanic families in 2003 as Fannie Mae and Freddie Mac combined. Additionally, nearly 80% of FHA purchase loans go to first-time homebuyers.

A significant number of FHA borrowers are low- and moderate-income borrowers. In 2003, approximately 58% of FHA's borrowers had an annual income under $50,000, while about 26% of conventional borrowers earned less than $50,000.

An FHA zero downpayment program will be good for consumers

FHA insurance is the appropriate means to close the homeownership gap among minorities and low- and moderate-income families.

As indicated before, the FHA program authorized under H.R. 3043 will not be the first no-downpayment mortgage product on the market. But it would be offered with features that should ameliorate risk for the families that need it. These important features include:

- H.R. 3043 mandates the homebuyers receive counseling by a HUD-approved counseling agency during the origination process.
- H.R. 3043 requires that loans be screened by FHA's Technology Open To Approved Lenders (TOTAL) mortgage scorecard. T.O.T.A.L. analyzes credit score among other factors in assessing a potential borrower.
- Homeowners with an FHA no downpayment loan will have the protections of FHA's extensive loss mitigation program, which offers them various options if they have problems after the closing of their loan.

With these safeguards, MBA is confident that the FHA zero downpayment product will allow good borrowers to become good homeowners.

MBA does have suggestions on minor improvements to H.R. 3043 that we believe would further strengthen an already strong program. Those ideas are as follows:

First, H.R. 3043 requires that counseling be conducted on an individual basis. MBA would suggest allowing classroom or group counseling under certain situations, as determined by the Secretary. Many state housing finance agencies and community-based not-for-profits, in conjunction with lenders, realtors, and other industry professionals, provide comprehensive homeownership counseling in classroom-based environment. This counseling is typically approved by Fannie Mae and Freddie Mac for

meeting mandatory counseling requirements under their programs. We believe that, in order to make the counseling best fit the borrower and to ensure that the counseling requirement itself does not become a disincentive to use the program, the statute should not mandate individual counseling, but rather allow the Secretary to determine the form and content of the counseling.

Second, the statute should explicitly state that the additionally disclosure documents, such as those required under subsection l(4)(B)(ii)(II) and under subsection l(10), are generic disclosures that can be used to educate the borrower. If the a counselor or lender must draft transaction-specific documents each time a potential zero downpayment borrower approaches them, it would create a significant disincentive for lenders and brokers in originating loans under the program.

MBA applauds Congressmen Tiberi and Scott for introducing this bill and demonstrating their commitment to closing the homeownership gap. Once again, thank you for allowing MBA to testify today.

We would be happy to furnish any additional needed information to the committee as it considers this bill.

Thank you.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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FEDERAL HOUSING ADMINISTRATION

Managing Risks from a New Zero Down Payment Product

Statement of William B. Shear, Director
Financial Markets and Community Investment

GAO-05-857T

June 30, 2005

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Highlights

Highlights of GAO-05-857T, a testimony to the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

FEDERAL HOUSING ADMINISTRATION

Managing Risks from a New Zero Down Payment Product

Why GAO Did This Study

To assist Congress in considering legislation to authorize the Secretary of the Department of Housing and Urban Development (HUD) to carry out a pilot program to insure zero down payment mortgages, this testimony provides information about practices mortgage institutions use in designing and implementing low and no down payment products. It also contains information about how these practices could be instructive for FHA in managing risks associated with a zero down payment product – a product for which the risks are not well understood. This testimony is primarily based on GAO's February 2005 report, *Mortgage Financing: Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*, (GAO-05-194).

What GAO Recommends

GAO suggests that Congress consider limiting any new no down payment product it may authorize. GAO recommends that HUD, among other things, consider piloting a no down payment product and that HUD establish a framework for when and how to pilot this and other new or changed products. HUD told us that they face challenges in administering a pilot program. We believe that HUD needs to further consider piloting or limiting volume of new or changed products, including a zero down payment product.

www.gao.gov/cgi-bin/getrpt?GAO-05-857T.

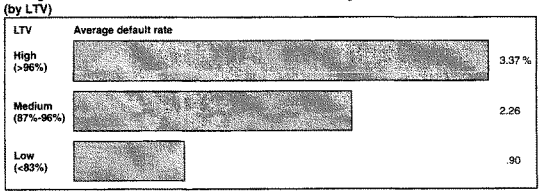
To view the full product, including the scope and methodology, click on the link above. For more information, contact William Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

In recent years, many mortgage institutions have become increasingly active in supporting low and even no down payment mortgage products. In considering the risks of these new products, a substantial amount of research GAO reviewed indicates that loan-to-value (LTV) ratio and credit score are among the most important factors when estimating the risk level associated with individual mortgages. GAO's analysis of the performance of low and no down payment mortgages supported by FHA and others corroborates key findings in the literature. Generally, mortgages with higher LTV ratios (smaller down payments) and lower credit scores are riskier than mortgages with lower LTV ratios and higher credit scores.

Some practices of other mortgage institutions offer a framework that could help FHA manage the risks associated with introducing new products or making significant changes to existing products. Mortgage institutions sometimes require additional credit enhancements, such as higher insurance coverage, and stricter underwriting, such as credit score thresholds, when introducing a new low or no down payment product. FHA is authorized to require an additional credit enhancement, but does not currently use this authority. FHA has used stricter underwriting criteria, but told us it is unlikely they would use a credit score threshold for a new zero down payment product. Mortgage institutions may also impose limits on the volume of the new products they will permit and on who can sell and service these products. FHA officials question the circumstances in which they can limit volumes for their products and believe they do not have sufficient resources to manage a product with limited volumes, but the potential costs of making widely available a product with risk that is not well understood could exceed the cost of initially implementing such a product on a limited basis.

Average Four-Year Default Rates for FHA Insured Loans Originated in 1998, 1999, and 2000 (by LTV)



Source: FY 2003 Actuarial Review of the Mutual Mortgage Insurance Fund.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to provide the committee with information and perspectives as it considers legislation that would authorize the Secretary of Housing and Urban Development (HUD) to carry out a pilot program to insure zero down payment mortgages. The Federal Housing Administration (FHA) at HUD currently insures low down payment mortgages to homebuyers across the nation. FHA requires homebuyers to make a 3 percent contribution toward the purchase of the home, though some of this may come in the form of a gift from others. FHA also permits some closing costs to be financed. My testimony today is primarily based on a report we completed for this Subcommittee on managing risks associated with low and no down payment loans, which was issued in February, 2005.[1] I will focus my discussion on the practices mortgage institutions use in designing and implementing low and no down payment products and how these practices could be instructive for the FHA in managing risks associated with a zero down payment product. A substantial body of research indicates that loans with lower down payments are generally riskier than those with higher down payments.

To obtain information for our report, we interviewed officials from FHA; staff at selected conventional mortgage providers;[2] private mortgage insurers; and two government-sponsored enterprises (GSE), Fannie Mae and Freddie Mac. We obtained information about the standards of low and no down payment mortgage products they support and the steps they take to design, implement, and monitor these products. However, we did not verify that these institutions, in fact, used these practices. We conducted this work from January through December 2004 in accordance with generally accepted government auditing standards.

In summary, there are several risk-management practices mortgage institutions use in designing, implementing, and monitoring low and no down payment products, and we believe these practices could be instructive for FHA in managing risks associated with a zero down payment product.

[1]GAO, *Mortgage Financing: Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*, GAO-05-194 (Washington, D.C.: Feb. 11, 2005).

[2]Conventional mortgages do not carry government insurance or guarantees.

- Mortgage institutions can mitigate the risk of low and no down payment products by requiring additional credit enhancements such as higher mortgage insurance coverage. For example, Fannie Mae and Freddie Mac require higher mortgage insurance for loans with a loan-to-value ratio (LTV) of great than 95 percent.[3] While FHA already will pay up to 100 percent of the losses from a foreclosure on a house, it does have the authority to share risk but does not currently use this authority.

- Mortgage institutions sometimes implement stricter underwriting to manage the additional risks associated with a new mortgage product. For example, institutions can require a higher credit score or higher reserves from the borrower. FHA has made adjustments to its underwriting criteria on its existing products but FHA officials told us that FHA is unlikely to mandate a credit score threshold for a zero down payment product.

- Mortgage institutions increase fees and charge higher premiums to compensate for the additional risks associated with a new mortgage product. For example, Fannie Mae officials stated that they would charge higher guarantee fees on low and no down payment loans if they were not able to require the higher insurance coverage. FHA is authorized to make, and has made, adjustments to its up-front and annual premiums on its existing products. The administration proposed higher premiums as part of its 2006 budget proposal for a zero-down payment product.

- Mortgage institutions sometimes use pilots or limit the initial availability of new products to build experience or better understand the factors that contribute to risk for these products. For example, Freddie Mac limited the initial availability of its 100 LTV product. Some mortgage institutions also may limit the origination and servicing of the product to their better lenders and servicers. However, FHA officials told us they face challenges in piloting and limiting mortgage products to certain approved lenders or servicers.

- According to officials of mortgage institutions, including FHA, they also often put in place more substantial monitoring and oversight mechanisms for their new products and then make changes based on what they learn. Some mortgage institutions, such as Fannie Mae, told us that they may conduct rigorous quality control sampling of new acquisitions, early payment defaults, and nonperforming loans. Depending on the scale of a new initiative, and its perceived risk, these quality control reviews could

[3]LTV is a ratio of the loan amount divided by the property sales price or appraised value of the house.

include a review of up to 100 percent of the loans that are part of the new product. FHA officials told us they also more closely monitor loans underwritten under revised guidelines.

In light of the risks that new lending products present and in recognition of established risk management practices, in our report, we suggested that Congress consider limiting the initial availability of any new single-family insurance product it may authorize, including a zero down payment product. We also suggested that Congress consider directing HUD to consider using various techniques for mitigating risks for a no down payment product, or products about which the risks are not well understood. We recommended that FHA consider using pilots for new products and for making significant changes to its existing products, regardless of any new products Congress may authorize. Additionally, we recommended that FHA explore various techniques for mitigating risks when implementing new products that have greater risk or for which risk is not well understood, such as a zero down payment product.

However, during the course of our work, HUD officials told us that they face challenges in administering a pilot program and they question the circumstances in which they can limit the availability of a new product. We believe that HUD needs to further consider piloting or limiting volume of new or changed products, including a zero down payment product. There are several available techniques for limiting an initial product that could help to address HUD's concerns, including limiting the time period in which it is available. Further we believe that in some circumstances the potential costs of making widely available a product when the risks of that product are not well understood could exceed the cost of initially implementing such a product on a limited basis. To the extent HUD believes it does not have the authority for exercising the options we describe, we recommend it seek the authority from Congress.

Background

Mortgage insurance, a commonly used credit enhancement, protects lenders against losses in the event of default, and FHA is a government mortgage insurer in a market that also includes private insurers. During fiscal years 2001 to 2003, FHA insured a total of about 3.7 million mortgages with a total value of about $425 billion. FHA plays a

particularly large role in certain market segments, including low-income and first-time homebuyers. In 2000, almost 90 percent of FHA-insured home purchase mortgages had an LTV higher than 95 percent. FHA insures most of its mortgages for single-family housing under its Mutual Mortgage Insurance (MMI) Fund. To cover lender's losses, FHA collects premiums from borrowers. These premiums, along with proceeds from the sale of foreclosed properties, pay for claims that FHA pays lenders as a result of foreclosures.

In recent years, other members of the conventional mortgage market (such as private mortgage insurers, government-sponsored enterprises such as Fannie Mae and Freddie Mac, and large private lenders) have been increasingly active in supporting low and even no down payment mortgage products. For example, Fannie Mae and Freddie Mac's no down payment mortgage products were introduced in 2000; and many private mortgage insurers will now insure a mortgage up to 100 percent LTV. However, the characteristics and standards for low and no down payment products vary among mortgage institutions. Currently, homebuyers with FHA-insured loans need to make a 3 percent contribution toward the purchase of the property and may finance some of the closing costs associated with the loan. As a result, an FHA-insured loan could equal nearly 100 percent of the property's value or sales price. In recent years, a growing proportion of borrowers have received down payment assistance, which further helps them meet the hurdle of accumulating sufficient funds to purchase a home. Based on our preliminary analysis of FHA-insured loans that had LTVs above 95 percent, use of down payment assistance has grown to over half of such loans insured during the first seven months of 2005.

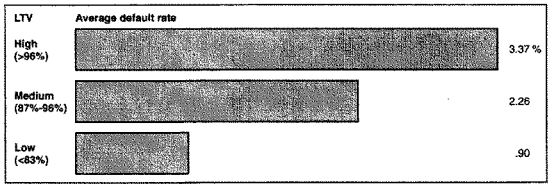
When considering the risk of mortgages, a substantial amount of research GAO reviewed indicates that the LTV ratio and the borrower's credit score are among the most important factors when estimating the risk level associated with individual mortgages.[4] We also analyzed the performance, expressed by the percent of borrowers defaulting within four years of mortgage origination, of low and no down payment mortgages supported by FHA and others.[5] Our analysis supports the findings we found in the research literature. Generally, mortgages with higher LTV ratios (smaller

[4]Credit scores are a single numerical score, based on an individual's credit history, which measures that individual's creditworthiness.

[5]Mortgage defaults and foreclosures typically occur at the highest rates 4 to 7 years after the mortgages are issued.

down payments) and lower credit scores are riskier than mortgages with lower LTV ratios and higher credit scores. As can be seen in Figure 1, when focusing only on LTV for FHA loans, default rates increase as the LTV ranges increase. In theory, LTV ratios are important because of the direct relationship that exists between the amount of equity borrowers have in their homes and the risk of default. The higher the LTV ratio, the less cash borrowers will have invested in their homes and the more likely it is that they may default on mortgage obligations, especially during times of economic hardship (e.g., unemployment, divorce, home price depreciation).

Figure 1: Average Four-Year Default Rates for FHA Insured Loans Originated in 1998, 1999, and 2000 (by LTV)



Source: FY 2003 Actuarial Review of the Mutual Mortgage Insurance Fund.

Risk assessment is a very important component of issuing and insuring mortgages, particularly when introducing a mortgage product that has the risk associated with a higher LTV. To help assess the risks associated with mortgages, the mortgage industry has moved toward greater use of mortgage scoring and automated underwriting systems.[6] Mortgage scoring is a technology-based tool that relies on the statistical analysis of millions of previously originated mortgage loans to determine how key attributes

[6]The mortgage industry also uses credit scoring models for estimating the credit risk of individuals— these methodologies are based on information such as payment patterns. Statistical analyses identifying the characteristics of borrowers who were most likely to make loan payments have been used to create a weight or score associated with each of the characteristics. According to Fair, Isaac and Company sources, credit scores are often called "FICO scores" because most credit scores are produced from software developed by Fair, Isaac and Company. FICO scores generally range from 300 to 850 with higher scores indicating better credit history. The lower the credit score, the more compensating factors lenders might require to approve a loan. These factors can include a higher down payment and greater borrower reserves.

such as the borrower's credit history, the property characteristics, and the terms of the mortgage note affect future loan performance.

During the 1990s, private mortgage insurers, the GSEs, and larger financial institutions developed automated underwriting systems. Automated underwriting systems refer to the process of collecting and processing the data used in the underwriting process. These systems rely, in part, on individuals' credit scores or credit history, and they have played an integral role in the provision of low and no down payment mortgage products. These systems allow lenders to quickly assess the riskiness of mortgages by simultaneously considering multiple factors including the credit score and credit history of borrowers. FHA has developed and recently implemented a mortgage scoring tool, called the FHA TOTAL Scorecard, to be used in conjunction with existing automated underwriting systems. More than 60 percent of all mortgages—conventional and government-insured—were underwritten by an automated underwriting system, as of 2002, and this percentage continues to rise.[7]

Several Practices Mortgage Institutions Use in Designing and Implementing Low and No Down Payment Products Could Be Instructive for FHA in Managing Risk of a No Down Payment Product

According to representatives of mortgage institutions we interviewed, they use a number of similar practices in designing and implementing new products. These practices can be especially important when designing and implementing new products with higher or less well understood risk, such as low and no down payment products. Some of these practices could be helpful to FHA in its design and implementation of a zero down payment product, as well as other new products. More specifically, mortgage institutions often establish additional requirements for new products such as additional credit enhancements or underwriting requirements. Although FHA has less flexibility in imposing additional credit enhancements it does have the authority to seek co-insurance, which it is not currently using. FHA makes adjustments to underwriting criteria and to its premiums, but told us that it is unlikely to use a credit score threshold for a new zero down payment product. Further, mortgage institutions also use different means to limit how widely they make available a new product, particularly during its early years. FHA does sometimes use practices for limiting a

[7]Susan Wharton Gates, Vanessa Gail Perry, and Peter Zorn, "Automated Underwriting in Mortgage Lending: Good News for the Underserved," *Housing Policy Debate*, 13, no. 2, 2002.

new product but usually does not pilot products on its own initiative. FHA officials with whom we spoke question the circumstances in which they can limit the availability of a program and told us they do not have the resources to manage programs with limited availability. Finally, according to officials of mortgage institutions, including FHA, they also often put in place more substantial monitoring and oversight mechanisms for their new products including lender oversight. In an earlier report, we made recommendations designed to improve HUD's oversight of FHA lenders.[8]

Mortgage Institutions Require Additional Credit Enhancements

Some mortgage institutions require additional credit enhancements—mechanisms for transferring risk from one party to another such as mortgage insurance—on low and no down payment products. Mortgage institutions such as Fannie Mae and Freddie Mac mitigate the risk of low and no down payment products by requiring additional credit enhancements such as higher mortgage insurance coverage. Fannie Mae and Freddie Mac believe that the higher-LTV loans represent a greater risk to them and they seek to partially mitigate this risk by requiring higher mortgage insurance coverage on these loans. For example, Fannie Mae and Freddie Mac require insurance coverage of 35 percent of the claim amount (on individual loans that foreclose) for loans that have an LTV of greater than 95 percent and require lower insurance coverage for loans with LTVs below 95 percent.

Although FHA is required to provide up to 100 percent coverage of the loans it insures, FHA may engage in co-insurance of its single-family loans. Under co-insurance, FHA could require lenders to share in the risks of insuring mortgages by assuming some percentage of the losses on the loans that they originated (lenders would generally use private mortgage insurance for risk sharing). FHA has used co-insurance before, primarily in its multifamily programs, but does not currently use co-insurance at all.[9] FHA officials told us they tried to put together a co-insurance agreement with Fannie Mae and Freddie Mac and, while they were able to come to

[8]GAO, *Single-Family Housing: Progress Made, but Opportunities Exist to Improve HUD's Oversight of FHA Lenders*, GAO-05-13 (Washington, D.C.: Nov. 12, 2004).

[9]According to FHA officials, FHA discontinued the multifamily co-insurance program after experiencing significant losses. Since then, Congress provided FHA authority to enter into risk-sharing agreements with GSEs and housing finance agencies on certain multifamily insurance.

agreement on the sharing of premiums, they could not reach agreement on the sharing of losses and it was never implemented.

Mortgage Institutions May Require Stricter Underwriting for New Low and No Down Payment Products

Mortgage institutions also can mitigate risk through stricter underwriting. For example, mortgage institutions such as Fannie Mae and Freddie Mac sometimes introduce stricter underwriting standards as part of the development of new low and no down payment products (or products about which they do not fully understand the risks). Institutions can do this in a number of ways, including requiring a higher credit score threshold for certain products, or requiring greater borrower reserves or more documentation of income or assets from the borrower. Once the mortgage institution has learned enough about the risks that were previously not understood, it can change the underwriting requirements for these new products. FHA could also benefit from mitigating risk such as through stricter underwriting. Although FHA has to meet some statutory standards, it retains some flexibility in how it implements a newly authorized product or changes an existing product. The HUD Secretary has latitude within statutory limitations in changing underwriting requirements for new and existing products and has done this many times.

The requirements in H.R. 3043 that prospective zero down payment loans go through FHA's TOTAL Scorecard and that borrowers receive prepurchase counseling are consistent with stricter underwriting. However, in addressing the final recommendations in our February report, FHA wrote that is unlikely to mandate a credit score threshold for a new zero down payment product because the new product is intended to serve borrowers who are underserved by the conventional market including those who lack credit scores. Also, FHA wrote that it is unlikely to mandate borrower reserve requirements since the purpose of a zero down payment product is to serve borrowers with little wealth or personal savings.

Mortgage Institutions May Increase Fees or Charge Higher Premiums

Mortgage institutions can increase fees or charge higher premiums to help offset the potential costs of a program that is believed to have greater risk. For example, Fannie Mae officials stated that they would charge higher guarantee fees on low and no down payment loans if they were not able to

require higher insurance coverage.[10] FHA could set higher premiums in anticipation of higher claims from no down payment loans. Within statutory limits, the HUD Secretary has the authority to set up-front and annual premiums that are charged to borrowers who have FHA-insured loans. In fact, in the administration's 2006 budget proposal for a zero down payment product, it included higher up front and annual premiums for these loans.

Before Fully Implementing New Products, Some Mortgage Institutions May Limit Their Availability

Some mortgage institutions may limit in some way a new product before fully implementing the new product. For example, Fannie Mae and Freddie Mac sometimes use pilots, or limited offerings of new products, to build experience with a new product type or to learn about particular variables that can help them better understand the factors that contribute to risk for these products. Freddie Mac and Fannie Mae also sometimes set volume limits for the percentage of their business that could be low and no down payment lending. Fannie Mae and Freddie Mac officials provided numerous examples of products that they now offer as standard products but which began as part of underwriting experiments. These include the Fannie Mae Flexible 97® product, as well as the Freddie Mac 100 product.

FHA has utilized pilots or demonstrations as well when making changes to its single-family mortgage insurance. Generally, HUD has done this in response to legislation that requires a pilot and not on its own initiative. For example, FHA's Home Equity Conversion Mortgage (HECM) insurance program started as a pilot. Congress initiated HECM in 1987; the program is designed to provide elderly homeowners a financial vehicle to tap the equity in their homes without selling or moving from their homes (sometimes called a "reverse mortgage"). Through statute, HECM started as a demonstration program that authorized FHA to insure 2,500 reverse mortgages. Through subsequent legislation, FHA was authorized to insure an increasing number of these mortgages until Congress made the program permanent in 1998. Under the National Housing Act, the HECM program was required to undergo a series of evaluations and it has been evaluated four times since its inception. FHA officials told us that administering this demonstration for 2,500 loans was difficult because of

[10]Fannie Mae and Freddie Mac charge fees for guaranteeing timely payment on mortgage backed securities they issue. The fees are based, in part, on the credit risk they face.

the challenges of selecting a limited number of lenders and borrowers. FHA ultimately had to use a lottery to limit loans to lenders.

H.R. 3043 also would mandate that FHA pilot the zero down payment program: it limits the annual number of zero down mortgages to 10 percent of the aggregate number of loans insured during the previous fiscal year, and sets an aggregate limit of 50,000 loans. The appropriate size for a pilot program depends on several factors. For example, the precise number of loans needed to detect a difference in performance between standard loans and loans of a new product type depends in part on how great the differences are in loan performance. If delinquencies early in the life of a mortgage were about 10 percent for FHA's standard high LTV loans, and FHA wished to determine whether loans in the pilot had delinquency rates no more than 20 percent greater that the standard loans (delinquency no more than 12 percent), a sample size of about 1,000 loans would be sufficient to detect this difference with 95 percent confidence. If delinquency rates or FHA's desired degree of precision were different, a different sample size would be appropriate.

FHA officials told us they have conducted pilot programs when Congress has authorized them, but they questioned the circumstances under which pilot programs are needed. FHA officials also said that they lacked sufficient resources to appropriately manage a pilot.

Additionally, some mortgage institutions may also limit the initial implementation of a new product by limiting the origination and servicing of the product to their better lenders and servicers. Mortgage institutions may also limit servicing on the loans to servicers with particular product expertise, regardless of who originates the loans. Fannie Mae and Freddie Mac both reported that these were important steps in introducing a new product and noted that lenders tend to take a more conservative approach when first implementing a new product. FHA officials agreed that they could, under certain circumstances, envision piloting or limiting the ways in which a new or changed product would be available but pointed to the practical limitations in doing so. FHA approves the sellers and services that are authorized to support FHA's single-family product, but FHA officials told us they face challenges in offering any of their programs only in certain regions of the country or in limiting programs to certain approved lenders or servicers. FHA generally offers products on a national basis and, when they do not, specific regions of the county or lenders might question why they are not able to receive the same benefit (even on a demonstration or pilot basis). However, these officials did provide examples in which their products had been initially limited to particular

regions of the country or to particular lenders, including the rollout of the HECMs and their TOTAL Scorecard.

Mortgage Institutions Establish Enhanced Monitoring and Oversight for New Low and No Down Payment Products and Make Changes Based on What They Learn

Mortgage institutions, including FHA, may take several steps related to increased monitoring of new products and subsequently make changes based on what they learned. Fannie Mae and Freddie Mac officials described processes in which they monitor actual versus expected loan performance for new products, sometimes including enhanced monitoring of early loan performance. Some mortgage institutions, such as Fannie Mae, told us that they may conduct rigorous quality control sampling of new acquisitions, early payment defaults, and nonperforming loans. Depending on the scale of a new initiative, and its perceived risk, these quality control reviews could include a review of up to 100 percent of the loans that are part of the new product. FHA officials told us they also monitor more closely loans underwritten under revised guidelines. Specifically, FHA officials told us that FHA routinely conducts a review of underwriting for approximately 6 to 7 percent of loans it insures. According to FHA officials, as part of the review, it may place greater emphasis on reviewing those aspects of the insurance product that are the subject of a recent change.

Fannie Mae and Freddie Mac also reported that they conduct more regular reviews at mortgage servicer sites for new products. In some cases, Fannie Mae and Freddie Mac have staff who conduct on-site audits at the sellers and servicers to provide an extra layer of oversight. According to FHA officials, they have staff that conduct reviews of lenders that they have identified as representing higher risk to FHA programs. However, we recently reported that HUD's oversight of lenders could be improved and identified a number of recommendations for improving this oversight.[11]

Conclusions

Loans with low or no down payments carry greater risk. Without any compensating measures such as offsetting credit enhancements and increased risk monitoring and oversight of lenders, introducing a new FHA no down payment product would expose FHA to greater credit risk. The administration's proposal for a zero down product included increased premiums to help compensate for an increase in the cost of the FHA program which would permit FHA to potentially offset additional costs

[11]GAO-05-13.

stemming from a new product that entails greater risk or not well understood risk. The proposed bill also requires that borrowers receive prepurchase counseling.

Although FHA appears to follow many key practices used by mortgage institutions in designing and implementing new products, several practices not currently or consistently followed by FHA stand out as appropriate means to manage the risks associated with introducing new products or significantly changing existing products. Moreover, these practices can be viewed as part of a formal framework used by some mortgage institutions for managing the risks associated with new or changed products. The framework includes techniques such as limiting the availability of a new product until it is better understood and establishing stricter underwriting standards—all of which would help FHA to manage risk associated with any new product it may introduce. For example, FHA could set volume limits or limit the initial number of participating lenders in the product. Further, changes in FHA's premiums, an important element of the administration's 2006 budget proposal for a zero down payment product would permit FHA to potentially offset additional costs stemming from a new product that entails greater risk or not well understood risk.

However, FHA officials believe that the agency does not have sufficient resources to implement products with limited volumes, such as through a pilot program. Yet, when FHA makes new products widely available or makes significant changes to existing products with less-understood risks, these products or actions also can introduce significant risks. Products that would introduce significant risks can impose significant costs. We believe that FHA could mitigate these risks and potential costs by using techniques such as piloting. Moreover, FHA told us that it believes that pilot programs are not needed because the risks of every new year of loans are assessed annually as part of credit subsidy budgetary transactions and in its annual actuarial study, and it could terminate the program early in its life if it identified problems.[12] However, because it may take a few years to determine the risks of a new loan product, early termination could still

[12]The Federal Credit Reform Act of 1990 requires that federal government programs that make direct loans or loan guarantees (including insuring loans) account for the full cost of their programs on an annual budgetary basis. Specifically, federal agencies must develop subsidy estimates of the net cost of their programs that include estimates of the net costs and revenues over the projected lives of the loans made in each fiscal year. The Cranston Gonzales National Affordable Housing Act requires an independent actuarial analysis of the economic net worth and soundness of FHA's MMI Fund.

expose the government to significant financial risk without some type of limits on the number of loans insured. If FHA is unsure about its authority to conduct pilots or concerned about expectations of equitable distribution of its products, Congress can make clear that FHA has this authority by requiring a product to be implemented as part of a pilot, or by explicitly giving the HUD Secretary the authority to establish and implement pilots for new products.

If Congress authorizes FHA to insure a no down payment product or any other new single-family insurance products, Congress may want to provide guidance and clear authority to FHA on this new product. Congress may want to consider a number of means to mitigate the additional risks that these loans may pose. Such means may include limiting the initial availability of such a new product, requiring higher premiums, requiring stricter underwriting standards, or requiring enhanced monitoring. Such risk mitigation techniques would serve to help protect the Mutual Mortgage Insurance Fund while allowing FHA the time to learn more about the performance of loans using this new product. Limits on the initial availability of the new product would be consistent with the approach Congress took in implementing the HECM program. The limits could also come in the form of an FHA requirement to limit the new product to better performing lenders and servicers as part of a demonstration program or to limit the time period during which the product is first offered.

Mr. Chairman, this completes my prepared statement. I would be pleased to respond to any questions you or other members of the Committee may have at this time.

GAO Contacts and Staff Acknowledgments

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Testimony Of

David F. Wilson

On Behalf Of the

National Association of Home Builders

Before the

United States House Committee on Financial Services

Subcommittee on Housing and Community Opportunity

On

H.R. 3043

"The Zero Downpayment Pilot Program Act of 2005"

June 30, 2005

Introduction

Mr. Chairman, Ranking Member Waters, members of the Housing and Community Opportunity Subcommittee, on behalf of the more than 220,000 members of the National Association of Home Builders (NAHB), thank you for the opportunity to testify before you today on H.R. 3043, the "Zero Downpayment Pilot Program Act of 2005," introduced by Representative Patrick Tiberi (R-OH). My name is David F. Wilson and I am the 2005 President of NAHB and a home builder and developer from Ketchum, Idaho. I have served as a senior officer of NAHB since 2002 and am a past President of the Idaho Building Contractors Association and the Wood River Idaho Building Contractors Association.

Let me begin by saying that NAHB supports H.R. 3043. Since its creation in 1934, the Federal Housing Administration has been an innovator in creating mortgage products that serve families that are either not served or underserved by the private market. This legislation will allow FHA to continue in this important tradition of innovation to address a primary obstacle that prevents many minority and low- and moderate-income families from becoming homeowners: the funds necessary for a downpayment. Furthermore, this legislation will enable FHA to temporarily remove this impediment to homeownership in a prudent manner and without negatively impacting FHA's Mutual Mortgage and General Insurance Funds.

H.R. 3043 would authorize the Secretary of Housing and Urban Development to insure zero downpayment mortgages for one-to-three unit residences provided that the borrower occupies one of the units. Currently, FHA requires most buyers to make a 3 percent minimum cash contribution to the

downpayment and closing costs under its 203(b) program. H.R. 3043 would eliminate this requirement. Homebuyer counseling would be required for all borrowers in the program, which NAHB believes is important. Loans in this program would be insured through HUD's Mutual Mortgage Insurance (MMI) Fund. As a pilot program, H.R. 3043 would enable 50,000 families to achieve homeownership. To assist in mitigating risk to FHA, the program would carry higher upfront and annual mortgage insurance premiums (MIPs) than HUD's other FHA single family programs. The upfront MIP is projected to be in the area of 2.25 percent compared with 1.50 percent for the FHA's standard mortgage insurance programs, while the annual MIP would start at 75 basis points and would decrease to 50 basis points after five years of satisfactory payment performance. Because the upfront MIP is normally included in the amount borrowed, the higher upfront and annual MIP would be reflected in slightly higher monthly payments.

Obstacles to Homeownership

Research suggests that the greatest obstacle faced by potential first-time homebuyers, especially low-income, minority individuals and families, is not the ability to make monthly mortgage payments, but rather the ability to assemble enough funds to pay the downpayment and closing costs. H.R. 3043 directly addresses this problem. According to a 1999 study by the US Census Bureau entitled "Who Can Afford to Buy A Home?", one of the top three reasons why families and individuals could not afford to purchase a house was a lack of cash or other financial assets for the downpayment and closing costs.

Data on accumulated wealth among homeowners and renters from the Federal Reserve's Survey of Consumer Finance support this point. These data

highlight the lack of wealth available to renter households for making a downpayment. Eighty-seven percent of all renters have less than $50,000 in wealth (these are the likely funds to be used for a downpayment to buy a home) while for minority renters that figure rises to ninety-four percent. With so little wealth and absent some downpayment assistance, it is inordinately difficult for large numbers of renters, especially minority renters, to become homeowners.

Many of these same renters also lack sufficient credit history or have less-than-perfect credit and, thus, cannot be served by existing zero downpayment products in the marketplace. For example, in the conventional market both Fannie Mae and Freddie Mac will purchase some form of no downpayment loan. Since zero downpayment options were introduced in the late 1990s, both of these secondary market organizations have expanded their suites of community development loan products aimed at reaching cash-strapped borrowers who wish to purchase homes in underserved markets. These products, created to reach borrowers in underserved markets offer alternatives to downpayments, such as soft second, or forgivable, mortgages from government agencies, employers or nonprofit organizations. For most if not all of these products, however, accessibility is still limited to borrowers having the most sterling credit records. There is a significant segment of the population that is not served by these conventional-market options who would benefit from an FHA-insured mortgage loan program. NAHB believes it fits well within the mission of FHA to provide a zero downpayment product to help facilitate more homeownership for this underserved population.

Safe and Sound FHA Operation

NAHB further believes that a zero downpayment program can be carried out in a safe and sound manner without harm to FHA's insurance funds.

First, the role of the downpayment in determining the credit worthiness of a potential homebuyer has diminished as underwriting technology has improved. Before the advent of automated underwriting, the amount of downpayment a prospective borrower could afford was a dominant factor in the underwriting decision. However, as the level of sophistication of automated underwriting tools has advanced, the ability of these tools to differentiate between high and low credit risk borrowers has improved. Specifically, FHA now requires lenders to use the Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard, when evaluating application for FHA-insured loans. This tool, which continues to be refined by FHA, will allow lenders to better evaluate borrowers before bringing them into the program.

Second, the risk to FHA from a zero downpayment product can be mitigated through appropriate underwriting and financing criteria. Again, NAHB points to HUD's own zero downpayment proposal where the MIPs will be higher than FHA's regular loan program to compensate for the higher risk of default. As stated earlier, the upfront MIP would be set at approximately 2.25 percent as compared to 1.50 percent, and the annual MIP would be 0.75 percent as compared to 0.50 percent. After five years, once borrowers have established a solid mortgage payment track record, the annual MIP would be reduced to 0.50 percent, the same as the regular program. HUD estimates that this approach results in no net cost to

the FHA MMI Fund and only increases the monthly payment on a $100,000 mortgage by $50.

Finally, housing counseling can further lower risk to FHA by ensuring that first-time homebuyers understand the process and the ongoing responsibilities of being a homeowner. HUD's own zero downpayment proposal included in its Fiscal Year 2006 budget request requires such counseling and we applaud that. The value of these programs is well documented and there are many local and state organizations around the country that provide housing counseling services. HUD itself funds many of these services through several grant programs of its own; however, these programs could be better organized and even enhanced to be more effective.

Enhancing the Soundness of the MMIF

Currently, the only way to address downpayment barriers for FHA borrowers is through downpayment assistance programs facilitated by nonprofit third parties. While these programs have contributed positively to homeownership expansion efforts, more options are needed. HUD's research has shown that loans assisted by these third party programs have experienced a much higher default rate than FHA's overall insured loan portfolio without compensating the FHA for the higher risk of loss. The FHA zero downpayment pilot program proposed in H.R. 3043 addresses the downpayment hurdle while allowing FHA to establish mortgage insurance premiums, underwriting and homebuyer counseling requirements targeted to that type of transaction.

Inclusion of Condominium/Cooperative Loans

NAHB is pleased that H.R. 3043 would apply to condominiums and cooperatives. In many communities around the country, single family detached homes are far out of the price range for low- and moderate-income families. Condominiums and cooperatives, on the other hand, are often within their reach and can provide the same wealth-building benefits for families as well as community development benefits for these neighborhoods.

NAHB Support for Homeownership Initiatives

A zero downpayment program would be a valuable addition to FHA's homeownership expansion tools that make homeownership possible for families otherwise unserved in markets throughout the nation and under all economic conditions. It is also an excellent opportunity to address the needs of prospective minority homeowners - an area in which NAHB has been working closely with the administration and other housing industry groups.

As one of the original partners in the "Blueprint for the American Dream," NAHB and its state and local affiliates are engaged in a number of efforts in support of the administration's initiative. NAHB has joined with HUD and other Blueprint partners in promoting events around the country designed to increase public awareness of minority homeownership opportunities. NAHB is dedicated to increasing public education regarding the many existing programs - public and private - that can help families achieve the dream of owning their own home. In addition, NAHB has been working with its network of state and local affiliates to find markets that could most benefit from education and outreach initiatives.

Finally, NAHB is working with other Blueprint partners to identify opportunities for cooperative outreach efforts.

Housing America's Working Families

NAHB believes that housing America's working families should be a key part of this nation's housing policy. Of particular concern to the building industry, are those men and women who work in their local communities, often as public employees, but cannot afford to live there. We need more funding for special programs that can help families buy or rent a home that meets their needs. These include downpayment assistance programs and tax credit programs that make rents more affordable. These programs make a difference for millions of families who are on the edge of affordability.

H.R. 3043 can help address our nation's "workforce" housing problem. The bottom line is that we need to move housing up on the list of priorities at all levels of government.

In addition, NAHB supports H.R. 1549 and S. 859, two important proposals which would implement a homeownership tax credit.

Conclusion

NAHB is pleased to note that this legislation is one of many proposed homeownership promotion initiatives under consideration by the Congress. Mr. Chairman, thank you again for the opportunity to share our views on the "Zero Downpayment Pilot Program Act of 2005". The members of NAHB work daily with families who want to partake in the American dream and own their first home. Time and again, our members witness the wealth-building effects of

homeownership for families and the community-building effects of homeownership for neighborhoods. H.R. 3043 will expand the number of those who can share in the American dream of homeownership.

We look forward to working with this committee, the Congress and the administration on expanding homeownership opportunities.

Thank you.

STATEMENT
OF
NATIONAL MULTI HOUSING COUNCIL/
NATIONAL APARTMENT ASSOCIATION

JOINT LEGISLATIVE PROGRAM

SUBMITTED TO THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

H.R. 3043, "THE ZERO DOWNPAYMENT PILOT PROGRAM ACT OF 2005"

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

THURSDAY, JUNE 30, 2005

Thank you for the opportunity to submit a statement for the record on H.R. 3043, the "Zero Downpayment Pilot Program Act of 2005." This statement is being submitted on behalf of the National Multi Housing Council (NMHC) and the National Apartment Association (NAA). At a time when foreclosures of conventional loans are near record-level, and FHA foreclosures are at their highest level ever and are still climbing, we ask whether this the time to place more first-time homebuyers in jeopardy?

Together, NMHC and NAA represent the nation's leading apartment firms. Our memberships are engaged in all aspects of the apartment industry, including ownership, development, management, and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms, and NAA is the largest national federation of state and local apartment associations, with 171 affiliates representing nearly 33,000 professionals who own and manage more than five million apartments.

NMHC and NAA commend you, Chairman Ney, for your leadership, and we thank the Members of the Subcommittee for your valuable work addressing the important issue of housing in America. You may wonder why two rental housing organizations are commenting on a bill to create zero-downpayment mortgages. Certainly there is nothing wrong with opening up the door to homeownership to more American households, but we must be careful not to oversell homeownership. Many families never question whether buying a house is a path to financial security. They just assume it is. But for too many, the joys of homeownership have turned into an agony of onerous and unsustainable debt that harms their financial future.

Before I explain our concerns with this and other recent homeownership proposals, I want to first dispel the notion that our objections are based solely on the apartment sector's fears that they will lose apartment residents and rental revenue if more households are given the opportunity to become owners. The truth is that more homeowners do not necessarily mean fewer apartment renters. Thanks to projected population growth, continuing strong immigration, and a dramatic increase in the number of single-person households, even if all of the proposed homeownership initiatives are implemented, there will still be enough new renters to fill the expected inventory of rental apartments. In fact a great number of our apartment firms actually offer their residents "rent to own" assistance to help them buy their first house.

In other words, when it comes to market share and profitability, housing is not a zero-sum game. However, the federal budget **is** a zero-sum game, and there is a growing disconnect between our housing policy and our housing needs. Every dollar allocated to homeownership incentives is a dollar taken away from other housing programs. And homeownership, while worthy, is not the best tool to solve our most pressing housing needs. The Congressionally-chartered Millennial Housing Commission concluded that homeownership alone cannot solve suburban sprawl, urban decline, the affordable housing shortage or the need to house our aging citizens. As a result, they said our top housing priority should be creating more rental housing.

Any policy that increases the already heavy public subsidies homeownership enjoys should be thoroughly evaluated against the nation's broader housing needs. Perhaps more importantly, we need to be aware of the real human costs of homeownership programs directed at low-income and poor credit households.

Too Much Homeownership Harms the Very Families You Are Trying to Help

We do hard working families a grave disservice when we encourage them to buy homes that they are not likely to be able to maintain or keep. Evidence suggests that we may already be pushing the homeownership envelope too far.

- Foreclosures of conventional loans are near record-level, and FHA foreclosures are at their highest level ever and are still climbing.[1]
    - Home foreclosures in North Carolina nearly tripled between 1998 and 2003, rising from 15,282 filings to 44,213. That's a 289 percent increase.[2]

[1] NMHC analysis.
[2] National Low Income Housing Coalition, "Update From the Field." *Memo to Members,* May 28, 2004. p. 5.

- Rising foreclosures are hitting local communities hard. In February 2004, Philadelphia officials temporarily suspended auctions of foreclosed homes after a record 1,120 homes were put up for bid in one week. A housing advocate was quoted as saying "this is the worst time for foreclosures basically since the Great Depression."[3]
- In Indianapolis, clusters of foreclosed homes are emerging. One block of older row houses has 20 vacant homes. FHA repossessions in Indianapolis are growing and are depressing prices in neighborhoods where they are concentrated. The sheriff responsible for Indianapolis reported 5,500 foreclosures in 2002 compared to about 1,000 a year in the mid-1990s.[4]
- Beyond the emotional damage caused by foreclosure, rising foreclosures create economic costs too. A 1995 study estimated that the average family loses $7,200 through foreclosure.[5] They also damage their credit rating, which makes it more difficult for them to buy, or even rent, another dwelling.

- Low- and zero-downpayment loans, in particular, are putting households at higher risk for default. Zero-downpayment mortgages failed miserably in the 1980's when tens of thousands of financially troubled mortgage holders had no recourse but to abandon their house and mail the keys back to their lender. Yet here we are, once again debating the merits of zero-downpayment loans.

- Homeownership is more expensive for the very households less able to handle it. Lower- and moderate-income households purchase a disproportionately larger share of older housing that depreciates at a faster rate and requires more frequent and costly maintenance.[6] As these houses deteriorate, many owners will find themselves with insufficient income to cover these costly repairs or rapidly rising property tax bills.[7]

- A growing number of households have put up only a few hundred dollars to buy an older house that is more expensive to maintain and is located in a neighborhood where wealth accumulation is not likely. With no cash reserves, many are one paycheck away from financial disaster if their incomes decline, their house values fall or expensive repairs are required.

- Highly leveraged buyers are at risk for owing more on their house than their houses are worth, particularly if fears of a real estate bubble come true. If prices in their neighborhood fall three to five percent in the first five years they own their house, and they have to move for personal or financial reasons, these cash-poor families will have to come up with 10 percent of their home's value in order to pay off their mortgage.

- Economists already worry about a housing bubble and housing price declines. Even without an actual bursting of the bubble, low-income households are at risk. One study of housing appreciation in Miami showed that appreciation rates are far more volatile over time in low-income and high-

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[3] Associated Press. "Some Seek Philly Auction Suspension." February 6, 2004. Found at www.abcnews.com on February 10, 2004.

[4] Kilborn, Peter T. "Easy Credit and Hard Times Bring a Flood of Foreclosures." November 22, 2002. *The New York Times.* Found at http://query.nytimes.com/gst/abstract.html?res=F30A11FE3A5D0C778EDDA80994DA404482 on May 7, 2004.

[5] Moreno A. 1995. The Cost-Effectiveness of Mortgage Foreclosure Prevention. *Family Housing Fund Report.* Minneapolis: Family Housing Fund as cited in George McCarthy, Shannon Van Zandt and William Rohe. 2001. *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research.* Washington, DC: Research Institute for Housing America, Mortgage Bankers Association. Working Paper No. 01-02. p. 30.

[6] George McCarthy, Shannon Van Zandt and William Rohe. 2001. *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research.* Washington, DC: Research Institute for Housing America, Mortgage Bankers Association. Working Paper No. 01-02. pp. 6 and 16.

[7] Nicolas Retsinas. Fall 1999. "Lower-Income Homeowners: Struggling to Keep the Dream Alive." *Housing Facts & Findings.* Washington, DC: Fannie Mae Foundation. p. 3.

minority tracts. In many such areas, nominal prices fell while prices in the metro area as a whole rose.[8]

- Since lower-income households are more likely to suffer job losses **and** are more likely to live in neighborhoods with declining house prices, homeownership can actually trap them in distressed neighborhoods, especially if they do not have enough equity in their homes to simply return the keys to the lender when homeownership becomes unsustainable.

- Many people assume that households with severe cost burdens (i.e., paying more than 50% of their income on housing) are renters. But our aggressive homeownership policies are pushing more and more owners into unaffordable situations.
    - According to the U.S. Department of Housing and Urban Development (HUD), the only group whose housing conditions worsened between 1999 and 2001 were low- and moderate-income owners, not renters.[9]
    - According to Harvard University, twice as many owners than renters pay 50% of their income for housing. From 2000 to 2003, and the number of lower and lower-middle income homeowners with severe cost burdens grew by more than one million.[10]
    - While the number of black homeowners in the 25 largest U.S. cities rose by 16 percent between 1990 and 2000, the number paying at least half their income for housing climbed 39 percent.[11]
    - Similarly, the number of Hispanic and Latino homeowners in the biggest cities jumped 54 percent in the last decade, but was overshadowed by a 98 percent rise in the number of Latino owners deemed to have "severe affordability problems."[12]

These facts make it clear that our often unquestioned embrace of homeownership may be doing more harm than good to many hard working Americans.

TOO MUCH HOMEOWNERSHIP IS NOT GOOD FOR LOCAL COMMUNITIES

Rental housing may not be as strong a political message as homeownership, but the plain fact is that this nation needs apartments in order to meet our housing needs. We need them for the 73 million Echo Boomers who are already graduating from college and looking for housing. We need them for the estimated 13 million immigrants who will come to this country in the next 10 years, looking for a place to start their new lives. We need them for the millions of hard working families who are paying more than half their income for shelter or living in substandard housing. We need them to help house the nation's nearly 74 million Baby Boomers as they age and can no longer take care of themselves.

Pushing the homeownership envelope too far can actually backfire and seriously damage the economic health of our communities. While homeownership can play a role in stabilizing neighborhoods, it can only do so if new homeowners are successful.

- If new owners cannot afford to maintain their homes, as is the case with many low-income households, nearby property values will fall. One study estimates that that average sales prices fall $788 for each 1 percent increase in tax delinquencies in a one- to two-block area of residence.[13]

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[8] George McCarthy, Shannon Van Zandt and William Rohe. 2001. *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research.* Washington, DC: Research Institute for Housing America, Mortgage Bankers Association. Working Paper No. 01-02. pp. 26-27.

[9] *Trends in Worst Case Needs for Housing, 1978-1999.* 2003. Washington, DC: Office of Policy Development and Research. U.S. Department of Housing and Urban Development. Found at www.huduser.org/Publications/PDF/trends.pdf.

[10] *The State of the Nation's Housing 2005.* Boston, MA: Joint Center for Housing Studies of Harvard University. p. 25.

[11] Simmons, Patrick. "A Tale of Two Cities: Growing Affordability Problems Amidst Rising Homeownership for Urban Minorities." Fannie Mae Foundation Census Note 14 (June 2004). Washington, DC: Fannie Mae Foundation.

[12] Simmons, Patrick. "A Tale of Two Cities: Growing Affordability Problems Amidst Rising Homeownership for Urban Minorities." Fannie Mae Foundation Census Note 14 (June 2004). Washington, DC: Fannie Mae Foundation.

[13] Simons, R. A., R. G. Quercia, and I. Maric. 1998. The Value of Residential Construction and Neighborhood

- If families default and abandon their houses, then cities, counties, towns and school districts also lose tax revenue and incur higher costs associated with vandalism and other social problems. One researcher estimated that the average FHA foreclosure costs cities $27,000.[14]

America's communities have learned the hard way that they need more apartments. Towns without sufficient rental housing forego valuable consumer spending and discourage businesses from expanding or relocating there because they cannot house prospective workers.

- To give one example, one study found that the Minneapolis-Saint Paul region forgoes an estimated $265 million per year in consumer spending and business income because it lacks sufficient housing for essential employees[15].

Towns need apartments to help revitalize distressed neighborhoods. The biggest housing success story of the last decade is the downtown revivals taking place from Philadelphia to San Jose. Decaying and abandoned city centers are being transformed into dynamic neighborhoods with new restaurants, shops and cultural attractions. These stories owe their success not to new homeownership initiatives, but to apartment developers who took a chance and created new housing downtown.

Towns also need apartments to accommodate population growth without adding to the nation's pollution and traffic congestion. Apartments concentrate development and conserve resources. By contrast, our homeownership initiatives only push development farther and farther out, creating costs for towns when they have to extend roads, water and sewer to new developments and find ways to offer police, fire and social services over a wider geographic area.

NOT EVERYONE WANTS TO OWN A HOUSE

Not only does America need apartment homes, but a growing number of Americans **want** them. America's tagline may be "a nation of homeowners," but actually one-third of our citizens are renters, and 40 percent surveyed report that they prefer to rent, even though they could afford to buy[16].

Apartments are no longer the housing of last resort. As American lifestyles have gotten busier, young professionals and empty nesters who could afford to buy are choosing to rent instead. They want the conveniences, amenities, shorter commutes and financial freedom that renting provides. Yet, for some reason, policy makers keep trying to push them into homeownership. This seems irresponsible; especially when research shows that half of all owners could have saved money by renting comparable housing.

The popularity of rental housing will intensify in the coming years as the groups most likely to prefer renting come to dominate our population. By 2020, singles and unrelated individuals living together will comprise one out of every three households. And 73 million Echo Boomers are getting ready to enter the housing market, typically first as renters.

Why do so many policy makers want Americans to own houses even when the households themselves have indicated that they prefer to rent? Often it is because they believe that apartment residents are sec-

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Disinvestment in Residential Sales Price. *Journal of Real Estate Research* 15(1–2):147–61 as cited on page 31 of George McCarthy, Shannon Van Zandt and William Rohe. 2001. *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research.* Washington, DC: Research Institute for Housing America, Mortgage Bankers Association. Working Paper No. 01-02.

[14] Simons, R. A., R. G. Quercia, and I. Maric. 1998. The Value of Residential Construction and Neighborhood Disinvestment in Residential Sales Price. *Journal of Real Estate Research* 15(1–2):147–61 as cited on page 31 of George McCarthy, Shannon Van Zandt and William Rohe. 2001. *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research.* Washington, DC: Research Institute for Housing America, Mortgage Bankers Association. Working Paper No. 01-02.

[15] GVA Marquette Advisors and Maxfield Research. *Workforce Housing: The Key to Ongoing Regional Prosperity* Found at www.fhfund.org/_dnld/reports/Workforce%20Housing_Full%20Report.pdf.

[16] *National Housing Survey, 2001.* Washington, DC: Fannie Mae.

ond-class citizens who cause property values to decline and crime rates to increase. But this is a throwback to the housing projects and tenements of an era gone by, especially now that one in five apartment households make more than $50,000 a year[17]. A Harvard University study found that average house values were the highest in working communities—which it defined as neighborhoods in which residents earn between 60 and 100 percent of the area-wide median income—with the most multifamily units[18]. They also report that between 1970 and 2000, home values increased in high multifamily working communities in each of the largest 42 metro areas.[19]

CONCLUSION

NMHC/NAA applaud you for recognizing the importance of housing issues in America, but it is time to realize homeownership is not for everyone, and it isn't a cure-all. We have real housing problems we need to solve, and we cannot solve them exclusively on the back of homeownership. We need more quality housing and a more balanced housing policy.

While we'd like to see a more balanced housing policy we are encouraged to see that the potential purchaser will receive counseling prior to applying for a loan, we believe that counseling should include rental-specific information. For example, we recommend that each purchaser be given counseling that includes an analysis of renting versus buying the exact home they are looking at, so as to provide them with a way to measure if the home purchase is indeed in their best interest.

NMHC/NAA urge Congress to consider all the impacts that a zero-downpayment program would have on society. Homeownership can be fantastic, but our nation's housing policy should not be so lopsided that people who are otherwise ill-equipped for homeownership are lured there only to regret it when the mortgage payments and repairs bills come due.

Thank you for the opportunity to submit our statement for the record.

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[17] NMHC tabulations of microdata for the U.S. Census Bureau's Current Population Survey, March Supplement, 1997-2003.

[18] Alexander von Hoffman, Eric Belsky, James DeNormandie, and Rachel Bratt. 2004. *America's Working Communities and the Impact of Multifamily Housing.* Cambridge, MA: Joint Center for Housing Studies, Harvard University and the Neighborhood Reinvestment Corporation. Working Paper 04-5. Found at www.jchs.harvard.edu/publications/communitydevelopment/w04-5.pdf.

[19] Ibid.