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REFORM OF FHA'S TITLE I MANUFACTURED HOUSING LOAN

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING AND TRANSPORTATION

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

EXAMINATION OF S. 2123, TO MODERNIZE THE MANUFACTURED HOUSING LOAN INSURANCE PROGRAM UNDER TITLE I OF THE NATIONAL HOUSING ACT

APRIL 4, 2006

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REFORM OF FHA'S TITLE I MANUFACTURED HOUSING LOAN PROGRAMS

TUESDAY, APRIL 4, 2006

U.S. SENATE,
SUBCOMMITTEE ON HOUSING AND TRANSPORTATION,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met, at 3 p.m., in room SD–538, Dirksen Senate Office Building, Senator Wayne Allard (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. I will call the Subcommittee on Housing and Transportation to order. We have a pretty tight schedule for most Members today, including my Ranking Member, Senator Reed, and so we are going to move the hearing along fairly quickly, and I want to get started on time so we can get as much covered as we can. When we hit 4 o'clock, we will probably draw the hearing to a close, and then if there are any questions that remains—and there likely will be—we will submit those to you and ask that you get them back to us within 10 days, if you would.

Homeownership has many benefits for communities and families, and both Congress and the President have pursued policies designed to support and promote homeownership. We have been successful, as evidenced by the current record high homeownership rates. Manufactured housing represents an important component of our homeownership gains.

According to Harvard's Joint Center for Housing Studies, in collaboration with the Neighborhood Reinvestment Corporation and the Ford Foundation, manufactured housing represents two-thirds of affordable housing added to the stock in recent years, and it is a growing portion of all new housing. In fact, buyers of manufactured housing contributed to a substantial share of the growth in low-income homeownership.

Manufactured housing can also be a particularly critical source of homeownership in areas where site-built construction can be more difficult or costly, such as in rural areas. Similarly, the difficult building conditions and the short construction season in many mountain communities can make manufactured housing an attractive alternative.

The manufactured housing industry has evolved from the trailers of the past. Consumers can choose from a vast spectrum of prebuilt homes, from very affordable mobile homes up to multimillion-dollar homes, completely indistinguishable from site-built homes. Some

manufactured housing is placed on land owned by the homeowner; whereas, other homes are placed on lots rented or leased by the homeowner. While land ownership can offer greater economic benefits and control, home-only purchases are often much more affordable.

Different financing models have evolved for different types of manufactured housing. Homebuyers with a real property title permanently sited on owned land are often able to access FHA's Title II program. To accommodate other homebuyers who have had personal property titles, in 1969 FHA's Title I program began insuring manufactured housing loans made by private lenders. While the Title I program has been important in promoting financing of manufactured housing, its usage has significantly declined due to key structural flaws. In 1992, the program insured 30,000 loans, but in recent years have seen fewer than 2,000 loans. We must find a way to fix these limitations and reinvigorate the program, a recommendation echoed by the Ford Foundation, the Neighborhood Reinvestment Corporation, Harvard's Joint Center for Housing Studies, the Millennial Housing Commission Report, and Frontline Systems in a HUD-commissioned report.

I have introduced legislation, Senate bill 2123, the FHA Manufactured Housing Loan Modernization Act, to reform the Title I program. My legislation patterns the Title I program on the successful Title II single-family program and incorporates many of the suggestions from the HUD-commissioned report. I am pleased to have Senators Bayh, Martinez, Dole, Johnson, Chambliss, and Lincoln join me in this strong bipartisan effort.

The bill would move the Title I program from a portfolio-based system to loan-by-loan insurance. This change would remove a significant barrier to lender participation. This would be balanced against lender accountability measures, including tighter underwriting standards by FHA, increased monitoring of FHA lenders, continued co-insurance and increased capital requirements for participating lenders.

My bill will also raise the loan limits, which have not changed since 1992. Updating the loan limits to reflect the current market price will make the Title I programs useful to more families. These changes will benefit homebuyers. A revitalized Title I program will better insure that families are able to access one of the most affordable sources of homeownership. As additional lenders come into the program, increased competition will lead to lower rates and costs.

Title I reform will also benefit the industry. The manufactured housing industry is currently in the midst of a 5-year downturn, partly stemming from over-tight credit conditions. The absence of Title I activity has inhibited the manufactured housing industry's recovery. More securitization will add liquidity to the market. Finally, my bill will benefit taxpayers, in part because it explicitly states that the program must become financially self-sufficient and actuarially sound. Also, the current structure of the Title I program leaves Ginnie Mae highly vulnerable to losses. In the late 1980's and early 1990's, Ginnie Mae lost millions. While they have since taken steps to stem the losses, some of the measures have inhibited the program. In some regards, losses have been minimized because the program is barely functioning. By setting insurance on a loan-

by-loan basis, Ginnie Mae will be better able to recoup losses, as it does under the Title II program.

Reform of FHA's Title I manufactured housing program will help promote one of the most affordable sources of homeownership. We have an excellent lineup of witnesses here today to discuss the issue.

First, we will hear from Brian Montgomery, Assistant Secretary for Housing and the Federal Housing Commissioner at HUD. I know that HUD is working on a broader FHA reform package, and we will be interested to hear how Title I may fit into HUD's proposal.

Next, we will hear from Michael Frenz, Executive Vice President of Ginnie Mae. At this point Ginnie Mae is no longer accepting new lenders into the program. We will be interested to hear about the circumstances that led to this point, as well as your reform suggestions.

Kevin Clayton of Clayton Homes will testify on behalf of the manufactured housing industry. As the President and CEO of a company that manufactures, sells, finances, and insures manufactured homes, he will be able to provide a valuable perspective.

Finally, we will hear from Kevin Jewell, a Consultant for Consumers Union. Mr. Jewell has written a number of reports on the manufactured housing industry.

I would like to thank all of the witnesses for appearing before the Subcommittee today. We appreciate your time, and your testimony will be helpful as the Committee continues to work on this issue.

Next, I would like to call on my colleague, Senator Reed, for any comments he may have.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman. Thank you for holding this hearing on the FHA Title I program, and I thank all the witnesses for your testimony and participation today.

Affordable housing is rare in today's market. The average cost of a home in the country today has topped $200,000. Back in Rhode Island, the average home price is now $265,000. And for this reason, I have been working with the Chairman on an amendment to the GSE reform bill that hopefully will create some affordable housing funds and help lower the price of it and make access to affordable housing more consistent throughout the country.

Manufactured housing is one of the means that low-income households can afford to own their own home. It plays an important role in augmenting affordable homeownership throughout this country. For example, for households with very low incomes, 23 percent of new homeowners purchase manufactured homes, and that is a significant benefit for these low-income households.

Despite these opportunities for low-income families to become homeowners, manufactured housing also has experienced some shortcomings that we will look at today, I hope, and discuss in some detail.

Particularly when it comes to manufactured homes situated on leased land. These homes tend to depreciate. Loans for these types of housing arrangements tend to have high interest rates, resulting in a larger loan payment, than payments for manufactured homes

on owned land. As a result of these interest rate peculiarities, default rates on loans for these homes tend to be considerably higher than conventional loans, in fact, as much as 4 times as high. And because these homes are considered personal property, buyers tend to be subject to fewer protections than homebuyers experiencing foreclosure. And depending on the State in which they live, consumers also tend to face less stable living situations, and they may have month-to-month leases that do not guarantee that they will be able to maintain their home on the land that they have leased.

And, finally, there is at least some circumstantial evidence of predatory lending practices involved in the purchase of these homes. That is something we want to look at.

Again, I think this is a wonderful opportunity to look seriously at these issues and try to advance a reform agenda, and I thank the Chairman for his efforts.

Thank you, Mr. Chairman.

Senator ALLARD. Thank you very much, and now we will go to the panel.

First of all, I would like to call upon Brian Montgomery, Assistant Secretary for Housing and the Federal Housing Commissioner, Department of HUD.

Mr. Montgomery.

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

Mr. MONTGOMERY. Thank you very much. Chairman Allard, Ranking Member Reed, and distinguished Members of the Subcommittee, thank you for the opportunity to testify on S. 2123, the FHA Manufactured Housing Loan Modernization Act of 2005. At your pleasure, I would like to submit my statement for the record.

Senator ALLARD. They will be made a part of the record.

Mr. MONTGOMERY. Thank you, sir.

In 1969, Congress expanded Title I insurance to cover loans on manufactured housing. Under Title I, FHA insures loans on manufactured housing that does not qualify as real estate. Title I borrowers may finance the purchase of a manufactured home and a land lot, or they may finance the manufactured home only or the land lot only. FHA-approved lenders make Title I loans eligible to borrowers from their own funds, and FHA insures the lenders against loss.

Secretary Jackson and I support the concepts presented in the bill introduced by Chairman Allard and agree that the Title I program is in need of reform. In fact, the Administration's FHA reform bill includes provisions very similar to those proposed by the Chairman. Certainly, both bills are intended to expand affordable housing opportunities and drive down consumer costs, while limiting risks to the Federal Government. HUD officials have discussed the proposed changes with industry leaders and manufactured home lenders, and I think we are all in agreement that the changes will accomplish these objectives.

The need for a viable Title I program is very clear. Nearly 22 million Americans, or roughly 8 percent of the population, live in

manufactured housing. If enacted, this legislation will expand the financing options for families seeking to purchase these types of affordable homes. In many areas of the country, particularly rural areas, manufactured housing is the only form of quality affordable housing available, so it is sensible to have a strong FHA program to help families buy these homes at a fair price.

At an average cost of $58,100—that is a 2004 figure—a manufactured home is typically more affordable than bricks and mortar homes, which cost on average $201,000, excluding the price of the land, I might add. In addition to value, today's manufactured homes offer new homebuyers many of the property features they desire. They can choose walk-in closets, fireplaces, or even "Energy Star" appliances.

If enacted, the program changes proposed by the Allard bill and the Administration's FHA reform legislation will modernize the Title I manufactured home program in a manner that we believe will encourage more lenders to participate in the program. Additional competition will drive down the financing costs for prospective homebuyers while improving the programs long-term financial soundness.

Both bills remove the key impediments that drove lenders away from Title I for the last several years, and both propose to increase the loan limits to levels that reflect today's manufactured housing prices. Both bills also propose that the limits be indexed to permit annual adjustments to keep them in line with actual home costs.

The most important change proposed in both bills is the conversion of Title I from a portfolio insurance program to an individual loan insurance program, similar to our current Title II program. This change will eliminate the most problematic statutory limitation of the program today, and that is the restriction on insurance claim payments to 10 percent of the value of a lender's loan portfolio.

This outdated portfolio insurance structure, which results in uncertainty and higher costs, was the primary reason Ginnie Mae curtailed securitization of Title I manufactured home loans in 1989. With portfolio insurance, lenders are not guaranteed coverage against loss and subsequently price their loans for additional risk. The higher loan costs, in turn, increase the likelihood of borrower default.

With additional default risk, but insufficient coverage, the losses grew to unsustainable levels in the 1990's, and Ginnie Mae pulled out of the program. The elimination of this outdated insurance model will encourage Ginnie Mae to reconsider participation in the secondary Title I securities market.

HUD's proposal is also consistent with S. 2123 in that it retains the 90-percent co-insurance feature of the Title I program, whereby FHA covers only 90 percent of the lender's loss. Co-insurance provides lenders with additional incentive to perform high-quality underwriting to protect themselves from loss. As such, the co-insurance feature will help ensure only responsible lenders participate in the program.

Finally, HUD agrees with and offers in its own legislation a provision stating that the insurance coverage should include a guarantee to lenders that their claims will be paid. We believe a

loan-level insurance model that includes such an "incontestability clause," guaranteeing insurance coverage, will help drive down the price of these loans, again by reducing the risk of loss to lenders.

This risk will be transferred to FHA. To address this, should either the Allard or larger FHA reform bill be enacted, FHA plans to implement additional risk control measures.

I mentioned at the outset of this testimony that HUD's bill is slightly different from S. 2123. One of the differences is the provision regarding insurance premiums. The Senate bill mimics the existing Title II coverage, with a 2.25-percent up-front premium cap, and retains the existing Title I annual insurance premium with a 1-percent cap. Our version, however, allows FHA flexibility in setting premiums at a level appropriate to ensure adequate cashflows and to cover potential losses.

For both the Title I and Title II programs, HUD is proposing a risk-based insurance premium structure. Combining a risk-based premium charge with the appropriate up-front underwriting standards, HUD will be able to operate the program in a more financially sound manner and, over time, at a negative credit subsidy rate, as proposed in the Allard bill. Although both bills propose that FHA operate the program in a self-sustaining manner, without the risk-based premium structure, it is unlikely FHA could operate the program at a break-even. FHA needs flexibility to set the premiums at appropriate levels to assure adequate cashflow to cover these costs.

This flexibility is particularly important because nonreal estate manufactured housing does not always appreciate in value. Defaults are more likely and recoveries are lower with this type of property. FHA will bear this additional risk and must have the ability to set premiums at levels commensurate with the risk.

While we look forward to working with the Subcommittee to find common ground on these issues, I want to make clear that HUD supports the underlying reforms in this legislation. As FHA Commissioner, I believe that modernization of the Title I program is long overdue and that the FHA Manufactured Housing Loan Modernization Act proposes appropriate modifications to make Title I a viable, affordable financing option once again.

In closing, I want to thank you, Mr. Chairman, Ranking Member Reed, and Senator Bayh for introducing legislation to improve Title I and for holding this important hearing. I appreciate the interest of the Subcommittee in the program and in expanding access to a critical form of affordable housing.

Thank you, sir.

Senator ALLARD. Thank you.

Now, we will call on Mr. Frenz, Executive Vice President of Ginnie Mae.

Mr. Frenz.

STATEMENT OF MICHAEL J. FRENZ
EXECUTIVE VICE PRESIDENT AND
CHIEF OPERATING OFFICER,
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION,
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. FRENZ. Thank you, Chairman Allard and Ranking Member Reed. I appreciate the opportunity to testify before you on efforts to modernize FHA's Title I manufactured housing loan program. At your pleasure, I would like my written statement entered into the official record.

Senator ALLARD. It will be entered in the record.

Mr. FRENZ. Ginnie Mae promotes affordable housing by linking local housing markets to global capital markets. We do this by guaranteeing payments to investors in mortgage-based securities that carry the full faith and credit of the U.S. Government.

Ginnie Mae's securities are comprised of loans individually insured or guaranteed by Federal entities: FHA, VA, Rural Housing Service—in the case of manufactured housing, FHA. Most types of Federal mortgage insurance reimburse lenders for most of the costs of delinquency and foreclosure, including principal and interest payments to investors that had not been collected from borrowers.

Ginnie Mae is called upon to honor its guarantee only when the financial institution that issued the security is unable to make payments to investors. Because the loans are individually insured, this generally happens when the financial institution fails.

When an issuer defaults on its obligation to pay Ginnie Mae security holders, Ginnie Mae assumes responsibility for servicing the portfolio and making payments to investors. At that point, Ginnie Mae's risk is dependent on the nature of the insurance or guarantee provided at the loan level.

Ginnie Mae began securitizing manufactured housing loans in the early 1970's. At the program's peak, approximately $3 billion of securities were outstanding and 30 to 40 issuers were active at a given time. Between 1986 and 1988, however, 12 issuers with $1.8 billion of securities defaults, resulting in Ginnie Mae assuming their portfolios and suffering large losses.

In 1989, due to those losses, Ginnie Mae imposed a moratorium on the acceptance of new issuers, which helped to limit subsequent losses. To date, Ginnie Mae has experienced $514 million of losses on manufactured housing portfolios.

Why were Ginnie Mae's losses on these portfolios so severe? A number of structural features unique to the Title I program exposed Ginnie Mae to risks that could not be mitigated. For the sake of brevity, I will focus on the two most important in terms of losses to Ginnie Mae.

The most important feature is the limit on insurance per lender. FHA limits its exposure by capping lender insurance coverage at 10 percent of all originations and purchases. Once claims reach 10 percent of the outstanding portfolio, the loans are effectively no longer insured, leaving issuers with little economic incentive to continue servicing loans and making payments to security holders. Ginnie Mae suffered large losses when assuming the portfolios of lenders that had exhausted FHA insurance coverage.

The second feature is that Title I loans are registered for insurance, but not reviewed by FHA for insurance eligibility at origination. Instead, FHA reserves the right to contest a claim for up to 2 years after claims are paid. This increases the risk to the issuer, or Ginnie Mae upon a default, that loans are not insured and raises costs for borrowers.

Today, the manufactured housing program at Ginnie Mae has almost completely wound down. There are four approved issuers in the program, with only one issuing new securities. During 2005, only $9 million in new securities were issued, and as of December 31, 2005, approximately $187 million were outstanding.

In summary, the structural features of the Title I program caused significant losses and made it impossible for Ginnie Mae to maintain a viable securitization program. To the extent that the Title I program is restructured to address those features, Ginnie Mae would consider lifting its current moratorium and working with FHA to support this important loan product that can help many Americans achieve their dreams of homeownership.

Thank you for this opportunity to discuss Ginnie Mae's experience with its manufactured housing securitization program. I will be pleased to answer any questions you have.

Senator ALLARD. Mr. Clayton of Clayton Homes.

STATEMENT OF KEVIN CLAYTON
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
CLAYTON HOMES, INC. ON BEHALF OF
MANUFACTURED HOUSING INSTITUTE AND MANUFACTURED HOUSING ASSOCIATION FOR REGULATORY REFORM

Mr. CLAYTON. Chairman Allard, Ranking Member Reed, thank you for the opportunity to comment, and I ask that my written statement be part of the offical hearing record.

Senator ALLARD. They will be made a part of the full record.

Mr. CLAYTON. Thank you. Clayton Homes is a vertically integrated modular and manufactured housing company owned by Berkshire Hathaway. We began 50 years ago and have been lending on manufactured housing for the past 35 years. Both of our lending affiliates—Vanderbilt Mortgage and 21st Mortgage—specialize in the origination and serving of $17 billion in manufactured home loans, including FHA Title I. I appear before you representing both the Manufactured Housing Institute and the Manufactured Housing Association for Regulatory Reform.

The manufactured housing industry today is in the midst of a severe economic downturn with production levels down 60 percent since 1998. The primary cause for this market contraction has been the loss of available financing for potential homeowners who apply for manufactured housing loans.

Manufactured housing has changed dramatically in recent years. The pictures that I shared with you indicate the positive and significant exterior and interior aesthetic enhancements. As material prices have skyrocketed, developers are now rushing to use manufactured housing as a more efficient means to build beautiful subdivisions.

Lending on manufactured housing has also changed. Today, the industry serves two distinct markets. First, over 80 percent of

current industry mortgages include real estate as part of the transaction. The other small segment, 20 percent or less, is the home-only market which is also a much needed and very important segment. The home-only segment serves families who want to enjoy homeownership without the additional burden of purchasing land. The majority of these owners are placing the home on family land. The common example is the grandparents allowing the kids to place a home on their property, but they are not about to let the kids require them to subdivide the land and encumber it with a lien.

During past industry recessions, the FHA Title I program provided much needed capital. However, in recent years, it has not functioned as Congress or FHA intended. Unfortunately, the current FHA Title I program is burdened with nonvalue-added processes causing it to serve less than 2,000 homeowners annually. This compares to 1992, when the program was insuring over 30,000 loans annually.

Unchanged since 1992, the loan limits are too low for today's manufactured home. The home-only program has a current loan limit of just $48,600 resulting in less than 1,000 square feet of living space, typically—too small for families today or to accommodate the aesthetic improvements of today's manufactured housing.

The Title I program has certain structural problems which make it very difficult for Ginnie Mae to recoup losses when lenders leave the program or go out of business. This has caused Ginnie Mae to severely limit the number of lenders for which it will guarantee loan securitizations. Thus, the advantages of the secondary market are greatly curtailed, particularly given Fannie Mae and Freddie Mac's limited participation. The end result is tens of thousands of low- to moderate-income homebuyers have been denied access to credit in this Federal Government program for several years.

S. 2123 will provide the necessary reforms to revive and stabilize this program. It would raise the loan limits and index them to inflation, and the legislation would also require that each loan be separately insured, like FHA Title II today.

To ensure that the Federal taxpayer is protected, the legislation requires the program to be actuarially sound by: Allowing HUD to increase the up-front insurance premium; directing HUD to address underwriting standards as market conditions dictate; strengthening the downpayment requirement; and maintaining the current requirement that lenders co-insure 10 percent of each insurance loss.

Each of these reforms was recommended in four independent studies which examined this program over the past 4 years. While the industry strongly supports these recommendations, we are open to other suggestions that might also improve and strengthen this program.

In closing, Mr. Chairman, we respectfully urge you to move S. 2123 through the legislative process as quickly as possible. Thank you for your time and attention to this important program, and I appreciate the opportunity to answer your questions.

Senator ALLARD. Mr. Jewell with the Consumers Union.

STATEMENT OF KEVIN JEWELL
CONSULTANT, MANUFACTURED HOUSING PROJECT,
ON BEHALF OF THE CONSUMERS UNION

Mr. JEWELL. Thank you, Senator Allard and Ranking Member Reed.

I am Kevin Jewell. I am with Consumers Union, and I request that my written comments be submitted for the record.

Senator ALLARD. Without objection.

Mr. JEWELL. In 2001, Consumers Union launched the Manufactured Housing Project with one goal, one question. And that question was: Does ownership of a manufactured home offer the same benefits as ownership of a conventional home?

The answer is, all too often, it does not. Market failures in the lending marketplace mean that consumers often end up owing more than they wish and end up underwater on a loan months or years after their purchase. Problems with warranty service and durability contribute to these failures.

The question is: What are the benefits of conventional homeownership? You mentioned that there are subsidies for homeownership: Why do we subsidize homeownership? I submit to you the two major factors discussed in the academic literature are stability and investment value. Stability allows people to build ties with their community, and payment on an asset that appreciates allows families to invest to build an asset.

The home-only product that is the focus of this legislation offers neither stability nor investment for the family. The question is: Can we add language to this bill to restore those benefits to the product? In terms of stability, we can. We can require that homeowners that buy under this product demonstrate long-term control of the land upon which that home is going to sit. That control could be land ownership, although if the consumer owns the land, we would encourage them to go with a real estate product. But as Mr. Clayton discussed, if they are placing the home on family land, and they are able to demostrate that the landowner is willing to issue them a long-term guarantee for the placement of that home, that would demonstrate control.

Freddie Mac, a few years ago, began a program called a leasehold program, where they offered personal property loans that required that the homeowner have a lease that was 5 years longer than the term of the loan. With the high loan-to-value that we see in this product, a consumer might have merely hundreds of dollars of equity for the first 5 to 10 years. If they are on a month-to-month lease, and the landowner decides they want to close the park or evict the homeowner, it may be in that consumers best interest to send that home back to the bank. The cost of moving a home—and remember, we do not call these mobile homes any more because they are not particularly mobile—the cost of moving a home easily runs into thousands of dollars and can damage the home, decreasing its value.

Requiring demonstration of stability and long-term control of the land is one needed change to this bill.

The other is, can we do anything about the fact that a home-only manufactured home loan is a depreciating asset? No, we cannot. Generally, manufactured homes that are not on owned land depre-

ciate. We can ensure that the purchase occurs at a reasonable price. That is where the appraisal standard in the bill helps. It prevents what we have seen in the past in this industry, where consumers end up paying too much for a home in the beginning. The creation of liquidity in the resale market, by providing loans for used homes, is a potential benefit of this bill. In fact, I would submit that it may be worthwhile limiting this program only to used homes. The new home market has private participants. The used home market does not have many active participants, and without a Government policy interest in creating investment opportunity or a Government policy interest in stability, we question the underlying interest in this legislation.

Thank you.

Senator ALLARD. I want to thank the panel for their testimony. Senator Reed and I will take 5 minutes apiece and ask questions. That will get close to 4:00 o'clock, Senator Reed. I know you have to get going and so do I, so we will pull the hearing to a close.

On this issue of choices for families, most of the families that choose to purchase manufactured housing that is not placed on owned land, actually, what choices do they have? And with these choices, are there reasonable alternatives out there that perhaps would fit one family but may not fit another? I am wondering if perhaps individually the members on the panel might want to comment on the choices that families have when they do not have the choice of putting a manufactured home on land. You want to comment on that, Mr. Montgomery?

Mr. MONTGOMERY. Yes, thank you, Mr. Chairman. Certainly speaking for my home State of Texas and many parts of that State, manufactured housing is about their only option that is reasonably priced. You go to a lot of parts of East Texas, that is about all you see for miles on end. For these families who are lower income, their options are limited, and one of the primary reasons we are looking at reforming Title I, just as we are Title II, in the case of Title I, just the interest rates are so onerous. And here we are at the U.S. Department of Housing and Urban Development, and we are only participating in 1,700, 1,600 loans throughout the whole country. Tells us right away that the program needs to be reformed, needs to be modernized.

We think by making some of the changes, Mr. Chairman, that are in your bill, certainly eliminating the 10 percent portfolio cap, doing some stricter underwriting on the front end, so that we can do a preendorsement review and guarantee that we can put FHA insurance on it, will certainly, we think, drive down interest rates and much more affordable to even more lower-income families, especially those who have very limited options, especially, again, in the rural communities where sticks and bricks construction is just so cost prohibitive.

Senator ALLARD. Any other comments?

Mr. CLAYTON. If I may?

Senator ALLARD. Yes, Mr. Clayton.

Mr. CLAYTON. The current industry data does show that 80 percent of these homes go on land where the land is part of the mortgage, so we are only talking about 20 percent of the overall market, and of that 20 percent, only 25 percent of that 20 percent are in

the land-lease community environment where they do have exposure to a landlord raising rents. It is not likely that grandparents are going to kick the kids off the land, and the common situation is that these homes are going on family land out there.

I hate to really wreak havoc on this program, the positive change we have made, based on that small population of homes that go into communities. And, of course, the good news is that in most States out there now there are laws that—and we are working with State associations across the Nation—address this land-lease issue. So the consumers have a lot of options on using this home-only product, and they are finding good uses for that.

Senator ALLARD. So we have rural areas where electricians are not necessarily readily available, or plumbers, the skilled trades that you need to build a home. I have tried building a home in a remote area and it is not easy because those people will not leave the more profitable urban areas to go into those areas. But you are saying these are family farms or family ranches or some family owned property, and they take a section of it and decide they want a home on it. They keep it within the family, but allow one of the kids, for example, to just purchase a home and take, in this case it would be a consumer loan on that one home, and that is something that you do not frequently run into?

Mr. CLAYTON. That is the most common loan—a home-only loan that does not have land. As you said, it is almost impossible to get an affordable site-built home out in a rural America, so manufactured housing is also great form of housing, and provides employment and labor for those people.

Senator ALLARD. Any other comments?

Mr. Jewell.

Mr. JEWELL. What we find is that in rural areas people tend to own the land or a relative owns the land because the land is inexpensive. It is in the urban areas that we find the majority of the park placements, and that is where the tenure problem is going to lead to a lack of stability.

Requiring an affidavit or a lease demonstrating long-term control of the land, a lease from the aunt or from the parent saying, "The owner of the home has a right to leave this home here for 5 to 10 years," is not going to impact those transactions. However, it will protect the consumer who buys a home on a month-to-month lease in a city, or in a year-to-year lease, and find out that the park owner was not willing to give them a 5-year lease. The homeowner may have planned on staying in that park for 10 years, for 20 years, but if they do not have stability of tenure, they should know that up front. The FHA should know that, because that is going to increase the risk of default.

Mr. CLAYTON. Could I make a comment?

Senator ALLARD. Mr. Clayton.

Mr. CLAYTON. With all due respect, since lending money beginning in 1972, we found that the grandparents do not look favorably on giving the kids guaranteed access to leave the home there for an extended period of time. I am afraid that you are suggesting a hindrance to this program that will stifle homeownership.

Senator ALLARD. I guess this a question I have. You may have some families where it is a good choice, some families where it is

a bad choice, and why would you exclude everybody, including those families for which it is a good choice? I guess that is the question that comes up at this particular point in time.

Mr. Jewell.

Mr. JEWELL. Thank you, Senator. We want them to be able to demonstrate that it is a good choice for them, and if FHA's loan is at the whim of the grandparents, the FHA should know that. Because the way that these loans are structured with the high loan to value, the equity builds very slowly, and it may be that the equity in the home will not cover the cost of moving that home to another location for 5 to 10 years. In that case, the consumer may be better off saying, "Repossess the home, because it is going to cost me $5,000 to move it, but I only have $100 in it or I only have $500 in it."

Senator ALLARD. Mr. Clayton.

Mr. CLAYTON. May I address that?

Senator ALLARD. Yes.

Mr. CLAYTON. This bill has the financial management belts and suspenders that if HUD finds a lender where the loans are not performing well—they can cut that lender off, they can raise the insurance premiums. This bill is absolutely crafted so that it will ensure reasonable loan performance.

Senator ALLARD. My time has expired. Go ahead, Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

Secretary Montgomery, just as a point of departure, FHA does not collect data on defaults on this title, do they?

Mr. MONTGOMERY. That is correct, Senator. We do not at this point. Right now, we only pay a claim on the back end, and even then, sometimes the lender has to jump through hoops for us to even approve paying a claim.

Senator REED. Does that point to a more aggressive review by FHA of this program in terms of getting the data on defaults?

Mr. MONTGOMERY. Yes, Senator. There are some parts of the Title I that could better mirror Title II, again, with the ultimate goal we think of having tighter underwriting, and a guarantee payment of a claim, which you do not have right now, we can drive down the cost of the loan.

Senator REED. Historically, there is a higher rate of default on these types of arrangements than on the usual real estate transaction, and I think we have all, again, returned consistently to this notion that leased land is a factor that might prompt this. Repossessions seem to be higher. Has any one at GAO or anyone else done an actuarial study about the likely effects of the reform proposals in terms of the FHA insurance fund?

Mr. MONTGOMERY. Senator, I am not aware of a GAO study looking at that, but you are absolutely right. As referenced earlier, the claim rate on these types of loans has been higher than it has been on a traditional Title II program. But I would say though, certainly as the volume has diminished through the years, so has the claim rate, and it is at its lowest level in many years.

Senator REED. But I presume from these efforts to reform the legislation, and also the huge demand for affordable housing, that the hope is that if this legislation is done properly, that the volume of FHA Title I loans on manufactured homes will increase dramati-

cally. And if there are structural problems already or actuarial problems already embedded in the program, we should know about those. So, I think it might be helpful if your Department would look actuarially at the impact of the reforms, so we start off with what we are going to put in place and grow is sound.

Let me ask a question to the whole panel, and that is the Ford Foundation sponsored a report by Harvard's Joint Center in 2002. One of the conclusions about manufactured homes, unless sited on owned-land, manufactured housing will have little or no potential to increase in value faster than the rate of inflation.

What mechanisms in the reform proposal will there be to protect a consumer from owing more than the value of the home? Why don't I start with Mr. Jewell and work my way down here.

Mr. JEWELL. One benefit that is in the bill is the language requiring appraisal, if properly implemented. One of the major historical problems with personal property loans was that consumers were buying the home for more than it was worth. There was no appraisal standard. There was an invoice standard. That meant from day one the consumer was under water. So that is a positive.

A danger especially for new homes, is that new manufactured homes have an unwrapping effect. It is a new manufactured home. A consumer signs a contract and it becomes a used manufactured home, and a used manufactured home is worth a lot less than a new manufactured home. Why would a consumer buy a used one when there is a new one just like it on the dealers' lot?

This drop in value, makes a high loan-to-value product, especially dangerous for new homes. My calculations show that if you are allowing 95 percent loan to value, and 2.2 percent of the insurance fees to be financed into the principal, and another 2 percent to come from outside sources, a consumer might have as little as three-quarters of 1 percent equity at the time of signing. If that transition from a new home to a used home drops the value more than three-quarters of a percent, that consumer is going to start out under water.

Senator REED. Let me ask a follow up on the appraisal. Would that appraisal include not just the structure itself, but the land, the lease, the value of the lease? Is that what this appraisal will look at?

Mr. JEWELL. That is what we would ask to be implemented. It is very important that the appraisal looks at the installed location value, not the value on the dealer's lot. The value after it has been installed on someone's land and inspected, including looking at its location and rent. But the implentation is something you would have to ask Mr. Montgomery.

Senator REED. Can you respond? Then I will finish up.

Mr. CLAYTON. Certainly. The premium being paid up front that Mr. Jewell referenced is exactly how FHA Title II, as I understand it, does that today as well. One way to control the equity, of course, is by limiting the loan term, so home-only loans are limited to 240 months, which is a good idea. These homes, mostly we are talking about now, costs $40, $50, $60 thousand. So that helps.

And the Harvard Study talked about, which is something the industry supports and is becoming very common, where the home-

owners actually take over ownership of their land-lease community, and that is something that we support wholeheartedly.

We are here today because in the 1990's lending from Wall Street came too easy, and now the rating agencies have basically just cut off all capital to this industry, and thus the need for why we are here today.

And just exactly as you said, an important part of this is the resale market. That is the one component, as this program gets some traction, that will be helped the most—the financing of used homes out there so the consumer can sell the home rather than defaulting.

Senator REED. Thank you.

Mr. Frenz, a quick comment, and then Secretary Montgomery, then I think the Chairman.

Mr. FRENZ. Sure. We believe that FHA's more stringent underwriting standards would help prevent certain abuses. We would significantly increase net worth requirements for lenders in our program to increase the likelihood that we would attract more reputable lenders. We would also monitor relationships between lenders and dealers to minimize abuses. We would require lenders, for example, to track delinquencies by dealer. We would also plan to develop more rigorous field review procedures, and we would conduct extensive due diligence on the officers and directors of companies applying to be in our program to minimize those types of abuses.

Senator REED. Thank you.

Mr. Secretary, quickly.

Mr. MONTGOMERY. Yes. I would just agree absolutely with Michael's observation. Also, FHA is one of the most transparent loan processes around. As you know, we have a punitive side to us as well with our Inspector General and GAO. By providing the mortgage insurance premium, we can drive the cost of loans, and certainly, the ironclad guarantee on the front end, which you do not have today, that will pay a claim, we are just saying everything would line up to make it more affordable, and we think decrease the likelihood that you would have a family getting upside down on a loan that you see today.

Senator REED. Thank you, Mr. Chairman.

Senator ALLARD. I have a question now for you, Mr. Montgomery. In your testimony, you testified that HUD proposes increasing the premiums, and then removing the premium caps, rather than just increasing the caps. Why do you suggest removing the caps entirely? This is a concern with the industry, and can we come to a point where you would accept caps at a certain level that would be acceptable maybe to HUD, somewhere along the line, is my question?

Mr. MONTGOMERY. Yes. Thank you, Chairman Allard, and that is certainly something we could discuss more at length on the surface. We are not opposed to setting some cap, whatever that cap may be, but we are, at FHA, on both the Title I and Title II side, looking to do what the conventional market has done for some time, and that is price a product more commensurate with a particular borrower's risk. Right now, the one-size-fits-all does not fit all any more. You have some lower risk borrowers paying more of

a premium, they should be. And the worse side of that, sir, is we have many families who are unable to use FHA because their FICO scores are lower.

And we think by being able to make the risk more flexible, if you will, sir, we can price it to the risk and also avoid some of the problems we may have had in the last 15 or 20 years.

Senator ALLARD. Do you think the 2.25 percent cap is insufficient in the bill?

Mr. MONTGOMERY. Mr. Chairman, I would like to go back and crunch the numbers, but what we are looking at on the Title II side is somewhere around 3 percent, but bear in mind, sir, these are caps. Under the risk-based pricing structure, other families could pay lower as well.

Senator ALLARD. Thank you.

This is for Mr. Frenz. In your testimony you mentioned that the current portfolio based system provides a moral hazard for lenders. Can you, please, elaborate on this, and do you believe that the proposed change to a loan-by-loan insurance system will eliminate the moral hazard?

Mr. FRENZ. Thank you, Mr. Chairman. It does create a moral hazard up until the point that the cap is reached, because as lenders have losses in portfolios and claims against the FHA fund, they can increase that 10 percent by adding loans at the margin. So up until the point where the cap is reached, it creates incentives for lenders to add more loans, which results in more risk to FHA and ultimately to Ginnie Mae.

I believe that a loan-by-loan insurance program and the elimination of a cap would largely eliminate that problem.

Senator ALLARD. So you support eliminating the cap?

Mr. FRENZ. I do.

Senator ALLARD. In our negotiations, I mean the industry has a problem in eliminating the cap. If there was to be a certain cap level in the bill, is there a level there where you think would be acceptable to you?

Mr. MONTGOMERY. Mr. Chairman, I could give you a number today, but——

Senator ALLARD. You suggested 3 percent.

Mr. MONTGOMERY. Three percent is what we are looking at on the Title II side, but we will certainly continue talking with the industry. I think they have been very open in their discussions of that matter.

Senator ALLARD. Mr. Frenz.

Mr. FRENZ. I would not be able to give you an answer today. I would have to discuss it with other people at Ginnie Mae and with Mr. Montgomery.

Senator ALLARD. Very good. Okay. Mr. Clayton, in your testimony you described the manufactured housing that a family could purchase under the existing loan limits. What kind of home would a family be able to purchase under the proposed loan limits in the bill? And for those who might think that the increases are too high, would you not agree that even under the new limits the home would still be reasonably modest?

Mr. CLAYTON. Yes, it would be. I suggest that the proposed limits are far from being too high, with material prices over the last 5

years having increased north of 30 percent for home builders. And so the limits that are proposed will work, and tying them to inflation is a necessary ingredient. But it would be a home that, obviously, if it has smaller square footage, then it could include some of the very nice aesthetic changes, which also help in the resale value, which is a very important component. It would also allow us to start financing homes with steeper-pitch roofs, things like that which would serve the consumer very, very well. I hope I addressed your question.

Senator ALLARD. I think you did. You are saying over what period of time was there a 30 percent increase in construction?

Mr. CLAYTON. Over 5 years.

Senator ALLARD. Over 5 years?

Mr. CLAYTON. We have seen them increased by 30 percent.

Senator ALLARD. So you think about 6 percent a year then on the average over 5 years, you end up with a 30 percent increase.

Mr. CLAYTON. Correct.

Senator ALLARD. And is this for manufactured housing, or is it just housing in general?

Mr. CLAYTON. I suspect that it is all housing in general. I speak to manufactured housing only.

Senator ALLARD. Okay. In manufactured housing though, there are certain advantages to manufacturers as opposed to construction that would help keep the cost of the product down. Do you still think that is as high as for the overall industry?

Mr. CLAYTON. I do because the material prices I am referring to are lumber, gypsum, steel.

Senator ALLARD. That is before you can start construction?

Mr. CLAYTON. Correct.

Senator ALLARD. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

One of the other issues that has come up is the arrangements between the dealers and the financiers, and sometimes these arrangements are too close for comfort. I think that Mr. Frenz referred to this in his comments. But could the panel respond to what steps you think should be taken to ensure that there is an appropriate relationship, and that these lending arrangements are not abusive or predatory?

Some of the things that I have heard about are requirements for either large downpayments or some type of arrangements on what the dealer sells the property, that locks the person in. Mr. Clayton, why don't you start?

Mr. CLAYTON. Thank you for the opportunity, because there have been major changes in the manufactured housing industry, particularly over the last 3 years, starting really with the law change that you supported, I assume, the law change in 2000, which mandated that all of our homes, by last year, have to be inspected at the set-up and delivery. So we are insuring a proper installation of homes. I might add that there is not a single manufactured home built after 1994, in any of the past hurricanes in the last 3 years, that was severely damaged. So it is a very sound, strong product that we are building today.

Lenders' best practices is something, as an industry association, that we enacted. Homebuyers will be able to choose those lenders,

if they so desire, that follow the lenders' best practices—those which do all the verifications of the customer data and the retailer information that has been provided to them.

Another industry program is, truth in invoicing—we call this TIPS. Every manufacturer has to stamp the invoice, saying that it as reflected, and there is total transparency as to what is in the invoice.

There is a community attributes program now that is out there, that gives the lender the ability to see what kind of community it is lending into—looking at rent increases, and other kinds of things, and rate each community before they lend into it.

So we think all these major initiatives really address some of the negatives that were brought up in manufactured housing in the late 1990's.

Senator REED. There are some other issues you might comment on, nonrefundable deposits in certain cases, and also a fee structure that discourages buyers from looking around for other lenders, rather than the approved lender. Is that commonplace now?

Mr. CLAYTON. It is not commonplace at all in the industry today. And we continue to work with State associations to address issues like that.

Senator REED. Mr. Jewell, any comments on these issues or the lending arrangements underlying the transaction?

Mr. JEWELL. Our experience in Texas: In 2001, 2002, and 2003, Consumers Union reviewed complaints at the Attorney General's Office, and at the Texas Department of Housing and Community Affairs, which regulates the manufactured housing community in Texas. We uncovered a pattern of nonrefundable deposits, difficulty for consumers to shop around for lending products. Unfortunately, the tying between lenders and manufacturers means that a consumer often does not have the bank on their side.

In a conventional home where you have a bank going into a real estate transaction, the bank does not want that loan to fail. With the manufactured homes—no one is saying that the manufactured home lender wants that loan to fail, but they are going to make money off of both the loan and the home. There is additional incentive for them to sell that home even if the financing in the transaction is a little questionable.

Senator REED. Mr. Frenz, and then Secretary Montgomery, and then I will relinquish my time. Any comments further?

Mr. FRENZ. My only further comment in addition to what I said earlier was that we would work with FHA to see what they are doing to monitor those relationships, and we would augment our field review efforts to help them out.

Senator REED. Thank you.

Secretary Montgomery, final word.

Mr. MONTGOMERY. Yes, sir. If this goes forward, we would certainly establish new and tighter underwriting guidelines for lenders to follow, including a preendorsement of review, similar to what we do on Title II. And I would also say again that FHA is one of the most transparent loan products out there.

Senator REED. Thank you.

Thank you, Mr. Chairman.

Senator ALLARD. I guess I am the bottom-line guy, so we will get to the ultimate question. If Senate bill 2123 or similar legislation is enacted into law, does Ginnie Mae intend to lift the current moratorium on the program and new lenders?

Mr. FRENZ. If the bill in its current form were to pass, Mr. Chairman, I believe we would.

Senator ALLARD. Thank you.

We are running out of time here. I think there will be more questions I think I want to present to the panelists, and I think maybe Senator Reed might have a few more questions he would like to send out. If you could respond within 10 days, the Committee would appreciate that.

I want to thank you for taking time to come to testify before the Committee. I know it is not easy to get away from your personal schedules to be here, but your testimony is important. It is important for us to understand the impacts of legislation and the impacts of what is happening in the current program. So, I thank you all for being here to help inform us.

With that, I will go ahead and adjourn the hearing. Thank you.

[Whereupon, at 4 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follows:]

PREPARED STATEMENT OF BRIAN D. MONTGOMERY

ASSISTANT SECRETARY FOR HOUSING—FEDERAL HOUSING COMMISSIONER
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

APRIL 4, 2006

Chairman Allard, Ranking Member Reed, and distinguished Members of the Subcommittee, thank you for the opportunity to testify on S. 2123, the FHA Manufactured Housing Loan Modernization Act of 2005. At your pleasure, I would like to submit my formal comments.

Title I is the Nation's oldest Federal housing loan insurance program, enacted in 1934 as part of the National Housing Act to permit the Federal Housing Administration (FHA) to insure home improvement loans. In 1969, Congress expanded Title I insurance to cover loans on manufactured housing.

Under Title I, FHA insures loans on manufactured housing that does not qualify as real estate. Title I borrowers may finance the purchase of a manufactured home and a land lot, or they may finance the manufactured home-only, or a land lot-only. Title I financing does not require the homebuyer to own the land where the manufactured home is located and the home does not have to be affixed permanently to the land. FHA-approved lenders make Title I loans to eligible borrowers from their own funds and FHA insures the lenders against loss.

Secretary Jackson and I support the concepts presented in the bill introduced by Chairman Allard and agree that the Title I program is in need of reform. In fact, the Administration's FHA reform bill includes provisions very similar to those proposed by the Chairman. Certainly, both bills are intended to expand affordable housing opportunities and drive down consumer costs, while limiting risks to the Federal Government. HUD officials have discussed the proposed changes with industry leaders and manufactured home lenders and I think we are all in agreement that the changes will accomplish these objectives.

The need for a viable Title I program is clear. Nearly 22 million Americans, or 8 percent of the population, live in manufactured housing. If enacted, this legislation will expand the financing options for families seeking to purchase these types of affordable homes. In many areas of the country, particularly rural areas, manufactured housing is the only forms of quality affordable housing available, so it is sensible to have a strong FHA program to help families buy these homes at a fair price.

At an average cost of $58,100 (as of 2004) a manufactured home is typically more affordable than "bricks-and-mortar" homes, which costs on average $201,418, excluding the price of the land. In addition to value, today's manufactured homes offer new homebuyers many of the property features they desire: Buyers can choose vaulted ceilings, walk-in closets, fireplaces, state-of-the-art appliances, spacious floor plans, and cost effective "Energy Star" upgrades. With growing public awareness and advances in technology, manufactured housing is well positioned to be a major provider of quality affordable housing in the years ahead.

If enacted, the program changes proposed by the Allard bill and the Administration's FHA reform legislation will modernize the Title I manufactured home program in a manner that will encourage more lenders to participate in the program. Additional competition will drive down the financing costs for prospective homebuyers while improving the program's long-term financial soundness.

Both bills remove the key impediments that drove lenders away from Title I for the last several years and both propose to increase loan limits to levels that reflect today's manufactured home prices. Both bills also propose that the limits be indexed to permit annual adjustments to keep them in line with actual home costs.

The most important change proposed in both bills is the conversion of Title I from a portfolio insurance program to an individual loan insurance program, similar to FHA's Title II programs. This change will eliminate the most problematic statutory limitation of the program today—the restriction on insurance claim payments to 10 percent of the value of lender's loan portfolio.

The outdated portfolio insurance structure, which results in uncertainty and higher costs, was the primary reason Ginnie Mae curtailed securitization of Title I manufactured home loans in the early 1990's. With portfolio insurance, lenders are not guaranteed coverage against loss and subsequently price their loans for additional risk. The higher loan costs, in turn, increase the likelihood of borrower default.

With additional default risk, but insufficient coverage, the losses grew to unsustainable levels in the 1990's and Ginnie Mae pulled out of the program. The elimination of this outdated insurance model will encourage Ginnie Mae to reconsider participation in the secondary Title I securities market.

HUD's proposal is also consistent with S. 2123 in that it retains the 90 percent coinsurance feature of the Title I program, whereby FHA covers only 90 percent of

the lender's losses. Co-insurance provides lenders with additional incentive to perform high-quality underwriting to protect themselves from loss. As such, the coinsurance feature will help ensure only responsible lenders participate in the program.

Finally, HUD agrees with and offers in its own legislation a provision stating that the insurance coverage should include a guarantee to lenders that their claims will be paid. We believe a loan-level insurance model that includes such an "incontestability clause," guaranteeing insurance coverage, will help drive down the pricing for these loans, again by reducing the risk of loss to the lenders.

This risk will be transferred to FHA. To address this, should either the Allard or larger FHA reform bill be enacted, FHA plans to implement additional risk control measures, including:

- collection of detailed borrower, property, and loan-level data into the insurance systems to improve tracking and performance measurement;
- development of more rigorous underwriting standards appropriate for this unique property type;
- establishment of up-front review procedures when loans are submitted for insurance; and
- enhancements to lender monitoring and enforcement of program compliance.

I mentioned at the outset of this testimony that HUD's bill is slightly different from S. 2123. One of the differences is the provision regarding insurance premiums. The Senate bill mimics the existing Title II coverage, with a 2.25 percent up-front premium cap, and retains the exiting Title I annual insurance premium with a 1.0 percent cap. Our version, however, allows FHA flexibility in setting premiums at a level appropriate to ensure adequate cashflow to cover losses.

For both the Title I and Title II programs, HUD is proposing a risk-based insurance premium structure. Combining a risk-based premium charge with appropriate up-front underwriting standards, HUD will be able to operate the program in a more financially sound manner and, over time, at a negative credit subsidy rate, as proposed in the Allard bill. Although both bills propose that FHA operate the program in a self-sustaining manner, without the risk-based premium structure, it is unlikely FHA could operate the program at "break-even." FHA needs flexibility to set the premiums at appropriate levels to assure adequate cashflow to cover costs.

This flexibility is particularly important because nonreal estate manufactured housing does not appreciate in value. Defaults are more likely and recoveries are lower with this type of property. FHA will bear this additional risk and must have the ability to set premiums at levels commensurate with that risk.

Another difference between the two bills is that the Administration's proposal retains FHA's existing Title I claims procedures, whereby lenders dispose of properties and then seek compensation from FHA. S. 2123 proposes that HUD dispose of properties conveyed by lenders in exchange for insurance benefits, similar to Title II. HUD has never performed this type of disposition of personal property, as opposed to real estate. FHA has neither the infrastructure nor the expertise to introduce such a practice and, thus, our legislation would retain the existing Title I property disposition process.

While we look forward to working with the Subcommittee to find common ground on these issues, I want to make clear that HUD supports the underlying reforms proposed in this legislation. As FHA Commissioner, I believe that modernization of the Title I program is long overdue and that the FHA Manufactured Housing Loan Modernization Act proposes appropriate modifications to make Title I a viable, affordable financing option once again.

In closing, I want to thank you, Chairman Allard, for introducing legislation to improve Title I and for holding this important hearing. I appreciate the interest of the Subcommittee in the program and in expanding access to a critical form of affordable housing for hundreds of thousands American families. Thank you for providing me the opportunity to testify today.

PREPARED STATEMENT OF MICHAEL J. FRENZ

EXECUTIVE VICE PRESIDENT & CHIEF OPERATING OFFICER
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GINNIE MAE)
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

APRIL 4, 2006

Thank you, Chairman Allard, Ranking Member Reed, and distinguished Members of the Subcommittee. My name is Michael Frenz and I am the Executive Vice Presi-

dent and Chief Operating Officer of the Government National Mortgage Association (Ginnie Mae). I have held this position since October 2004.

I appreciate having the opportunity to testify before you on S. 2123, the FHA Manufactured Housing Loan Modernization Act of 2005.

Section 2 of this bill (Findings and Purposes) states, "The dramatic reduction in the use of the Title I program is due primarily to certain structural problems of the program, which have resulted in refusal by Ginnie Mae to accept new participants into the program . . . ." It is my intention today to provide a thorough description of the structural features of the current Title I program that exposed Ginnie Mae to significant risks, and ultimately led to Ginnie Mae's decision to curtail its exposure to these risks by imposing a moratorium on the approval of new issuers of securities backed by Title I loans.

Ginnie Mae's Mission

Ginnie Mae's mission is to support affordable housing by linking local housing markets to global capital markets. We do this by guaranteeing mortgage-backed securities (MBS). Ginnie Mae securities carry the full faith and credit guarantee of the U.S. Government. Ginnie Mae has securitized more than $2.4 trillion in MBS, helping more than 32 million low- and moderate-income families become homeowners. Additionally, we meet our mission without directly buying, selling, or issuing securities. Instead, we guarantee MBS issued by private financial institutions. The Ginnie Mae full faith and credit guarantee assures investors they will receive timely payments of principal and interest on their securities.

A clear understanding of the nature of the Ginnie Mae guarantee—that is, that Ginnie Mae insures investor payments, not borrower mortgages—and the manner in which its business model limits exposure to credit risk is crucial to understanding the challenges we have encountered in our manufactured housing securitization program.

Ginnie Mae's securities are comprised of loans backed by single-family, multifamily, and manufactured housing units. These loans are individually insured or guaranteed by the Federal agencies with which Ginnie Mae partners—in the case of manufactured housing, FHA.

The Ginnie Mae guarantee is activated only when the financial institution that issued the security fails to meet its obligation to make security payments to the investor. Because the loans are individually insured, this generally happens only when an institution fails.

The existence of loan-level insurance coverage provided by other Federal agencies typically means that Ginnie Mae assumes minimal credit risk. When an issuer fails, Ginnie Mae steps in, assumes responsibility for the portfolio, and becomes subject to the same risks as the issuer, where losses are influenced by borrower credit risk, the value of the underlying collateral, and the time it takes to dispose of that collateral. As a result, like any other issuer, Ginnie Mae's risk exposure is largely dependent on the nature of the insurance or guarantee provided at the loan level.

Ginnie Mae began securitizing manufactured housing loans in the early 1970's. At the peak of the manufactured housing program, Ginnie Mae guaranteed approximately $3 billion worth of securities, and had about 30 to 40 active issuers. Between 1986 and 1988, however, 12 Ginnie Mae issuers with $1.8 billion of securities backed by Title I loans defaulted, resulting in Ginnie Mae assuming their portfolios and suffering significant losses.

One of the actions Ginnie Mae took to mitigate this risk was to impose a moratorium on the acceptance of new issuers into the manufactured housing program in 1989. This moratorium helped limit Ginnie Mae's subsequent losses; since 1989 only 10 more issuers with about $500 million of securities defaulted. To date, Ginnie Mae has experienced $514 million of losses on these defaulted portfolios.

Title I Structural Features

Why were Ginnie Mae's losses on these portfolios so severe? A number of structural features unique to the Title I program exposed Ginnie Mae to risks that, for all intents and purposes, could not be mitigated. These features include:

- The existence of limits on the amount of FHA insurance per lender;
- The existence of coinsurance between FHA and the lender;
- The underwriting process for Title I loans; and
- The calculation for the payment of claims by FHA.

While each of these features serves to mitigate FHA risks, the collective impact exposed Ginnie Mae to significant risk, rendering its losses more severe and less predictable. I would now like to take the time to discuss each of these features in greater detail.

First, Title I requires FHA to limit its loss exposure by capping lender insurance coverage at 10 percent of all originations and purchases. After FHA pays the lender claims in an amount equal to the 10 percent cap, it will pay no additional claims. In other words, insurance is not provided on a per loan basis, but rather is limited to a defined percentage of each lender's portfolio. Tying the maximum amount of insurance coverage available to lenders to the volume of loans originated, created a classic moral hazard problem: As lenders' portfolios experienced losses, they were incented to make more loans in order to increase the amount of claims payments for which they were eligible. And, when the claim limits were reached on troubled portfolios, lenders had little incentive to continue servicing portfolios and were more likely to stop making payments to security holders. Thus, Ginnie Mae sustained substantial losses when it assumed the portfolios of these lenders who had already exhausted their FHA insurance coverage.

Second, Title I is a coinsurance program: At the loan level, FHA reimburses a lender for 90 percent of the loss, and the lender takes the remaining 10 percent of the loss. While coinsurance can decrease the incentive for lenders to make risky loans, it had the opposite effect when combined with the portfolio cap; coinsurance caused lenders to reach their caps, which in turn resulted in significant losses for Ginnie Mae.

Third, Title I loans are registered for insurance, but are not endorsed. This means that, unlike for Title II loans, FHA does not review Title I loan eligibility for insurance coverage at origination. Instead, FHA reserves the right to contest the payment of a claim on a manufactured housing loan for up to 2 years after it has already paid the claim. Therefore, a lender has no assurance that a loan in its portfolio will be eligible for insurance and a claim will be paid. This differs from Title II single-family loans, where the insurance contract is deemed to be incontestable upon endorsement of the loan. While this is a prudent practice for FHA, to the extent that Ginnie Mae takes a defaulted portfolio, this feature exposes Ginnie Mae to potentially higher losses.

Finally, the Title I formula for calculating FHA's payment of claims limits the amount of the claim to the outstanding principal balance of the loan less the appraised value of the manufactured housing unit. Often the market value of the manufactured home is less than the appraised value. If the sales price of the manufactured housing unit falls short of the appraised value, the difference is the lender's responsibility. This provision limits FHA's exposure, but increases losses suffered by the lender—and by Ginnie Mae in the event of an issuer default.

Taken together, these four structural features of the Title I program contributed to the significant losses experienced by Ginnie Mae. Today, the manufactured housing program has been almost completely wound down.

There are now only four approved issuers in the Ginnie Mae manufactured housing program, with just one currently active. In 2005, only $9 million in new securities were issued, and the total amount of securities has steadily decreased to the point that, as of the end of 2005, there were only approximately $187 million outstanding. In addition, the total remaining balance of the manufactured housing portfolios that Ginnie Mae assumed due to issuer defaults has decreased to $53 million, of which $25 million is in the form of Ginnie Mae securities, and $28 million is in loans and repossessed manufactured housing units.

Conclusion

The structural features that I have discussed today made it impossible for Ginnie Mae to maintain a viable manufactured housing securitization program. To the extent that the Title I program is restructured, Ginnie Mae would consider lifting its current moratorium on the program and work with FHA to support this important product that helps many Americans achieve their dream of homeownership.

Thank you for this opportunity to discuss Ginnie Mae's experience with its manufactured housing securitization program, and I would be pleased to answer any questions you may have.

PREPARED STATEMENT OF KEVIN CLAYTON

PRESIDENT AND CHIEF EXECUTIVE OFFICER, CLAYTON HOMES, INC.

APRIL 4, 2006

Introduction

Chairman Allard and Members of the Housing Subcommittee, my name is Kevin Clayton. I am the President and Chief Executive Officer of Clayton Homes, Inc.

which is headquartered in Maryville, Tennessee. We are a national, vertically integrated modular and manufactured housing company owned by Berkshire Hathaway. Through our family of brands, we build, sell, finance, lease, and insure a full spectrum of affordable housing. Since 1972, we have been successfully originating and servicing manufactured homes loans, including FHA Title I loans. I am here today representing both the Manufactured Housing Institute (MHI) and the Manufactured Housing Association for Regulatory Reform (MHARR). Today's manufactured homes have evolved dramatically over the past decade with home designs and floor plans that appeal to a growing number of American families. I respectfully request that this written statement be made part of the official hearing record.

It is an honor to appear before you today to testify in strong support of S. 2123, the "FHA Manufactured Housing Loan Modernization Act of 2005." This bill was introduced by Subcommittee Chairman Wayne Allard who was joined by full Committee Members Evan Bayh and Mel Martinez as original cosponsors. S. 2123 represents a bi-partisan effort to reform an important affordable housing program. The FHA Title I mortgage insurance program insures loans made by private lenders to finance the purchase of manufactured homes that will be placed primarily in land-lease communities or private land. This program is targeted to benefit lower-income homebuyers to find adequate affordable housing who are particularly challenged with escalating material prices.

Background

The manufactured housing industry has gone from 376,000 building starts in 1998 to approximately 145,000 in 2005. This represents a sixty percent (60 percent) decline in housing shipments and sales. The primary cause for this market contraction has been the loss of available financing for potential homeowners who apply for a manufactured housing loan. As a result, the industry has not been able to serve the housing needs of individuals and families of low- to moderate-income who want to purchase a home without the encumbrance of land or real estate.

In the past, when credit availability became curtailed, the FHA Title I program provided much needed liquidity. In recent years, however, FHA Title I has not functioned as an "automatic stabilizer" in the marketplace. During the early 90's, Title I insured over 30,000 loans per year. In each of the past 3 years, FHA Title I insured less than 10 percent of that amount, or less than two thousand (2,000) manufactured home loans per year. While Fannie and Freddie are permitted under their charters to purchase and to create a secondary market for "home-only" loans, both GSE's have not done so to date. The sole secondary market participant for Title I loans is the Government National Mortgage Association (Ginnie Mae). As described below, Ginnie Mae's participation in this market has been extremely limited in recent years.

Ginnie Mae, which facilitates the securitization of FHA loans, attributes the decline of Title I activity to certain "structural problems" which make it very difficult for it to recoup its losses when lenders go out of business. This does not happen with FHA Title II (real property) loans because under that program, insurance is set on a loan-by-loan basis. Ginnie Mae officials have stated that if these structural problems (especially the insurance issue) can be addressed as submitted within, they would end the moratorium on certifying new lenders and would help facilitate the securitization of more Title I loans. This would add much needed liquidity to the program.

Current System

The existing loan limits are set by statute and have not been increased since 1992. Ninety-five percent of the loans insured under Title I are "home-only" transactions. Such loans are also commonly referred to as personal property or chattel loans.

The current loan limit set by Congress in 1992 for "home only" loans is $48,600. This amount is woefully inadequate to meet the average loan needed to purchase a manufactured home and it remains one of the primary reasons for the recent inactivity in the Title I program. The current loan threshold would limit homebuyers to a single-section manufactured home which, on average, would be less than 1,000 square feet in living space and lack many of today's aesthetic improvements to manufactured housing. Such cramped living quarters are hardly conducive to family living.

One of the bill's purposes is to move the current weak and inefficient Title I insurance system for manufactured housing toward the stronger and more mainstream Title II insurance system. One of the weaknesses of the current system is that the underwriting standards are very vague and leave too much discretion to individual lenders. FHA does not review lender underwriting today—the insurance is auto-

matic with few financial safeguards. The insurance premiums are also too low which further exacerbates the fiscal soundness of this program.

Another weakness is that, unlike Title II where every loan is fully insured, under Title I FHA maintains a separate account for each lender for future claims equal to 10 percent of the principle balance of all Title I loans that lender originates. For example, if a lender originates $1 million in Title I manufactured home loans, only $100,000 is insured by FHA—the remaining $900,000 in not covered. Once that account becomes depleted due to foreclosures and insurance payouts, there is no insurance coverage remaining to pay future claims for loans that particular lender had originated. If additional loans end up in foreclosure and if the lender has inadequate loan reserves, Ginnie Mae (which guarantees the timely payment of principal and interest to investors) must compensate investors for principle and interest payments owed to them. During the 1990's, this insurance system created large losses for Ginnie Mae and resulted in it refusing to issue certificates (eagles) to all but three manufactured housing lenders.

Proposed System

The new system proposed under S. 2123 would require that each loan be insured separately, as with Title II today. The bill would also institute a new system of financial "belts and suspenders" whose purpose is to provide a negative credit subsidy for taxpayers, which the legislation mandates. Specifically, the bill would: Require HUD to increase the upfront insurance premium and address underwriting standards; strengthen downpayment requirements; increase lender capital requirements; and maintain the current requirement that lenders coinsure 10 percent of each insurance loss. The current lender "account system" would disappear and each loan would be insured by FHA, similar to the Title II program today.

Under S. 2123, each party to the transaction would be responsible and held accountable for loan performance: The borrower would be required, of course, to keep monthly payments current; HUD would be responsible for increasing insurance premiums and addressing underwriting standards as market conditions dictate; and the lender would be accountable for 10 percent of the losses on loan defaults.

As mentioned, the loan limits have not been increased since 1992. S. 2123 would remedy this by instituting a one-time loan limit increase of 40 percent pegged to the current limits. While this might sound like a large increase, in reality it is not when you take into account the fact that production costs for the construction of manufactured homes have increased by over 50 percent since 1992. The new loan limits would be indexed for inflation going forward under the same consumer price index (CPI) used for other FHA programs.

The sum total of these reforms would result in lower-income families across the country being able to utilize the Title I program to purchase larger homes. In addition, the new financial safeguards will allow FHA to insure every loan. This should increase Ginnie Mae participation with more lenders being certified to issue Ginnie Mae securities. More securitizations would open up the secondary market for these loans—hopefully adding much needed liquidity and resulting in lower interest rates and fees. The ultimate beneficiaries, of course, would be low- and moderate-income homebuyers who will be able to enjoy more living space at a lower cost of financing.

Independent Studies In Support of Reform

Over the course of the past 4 years, four independent housing studies have been performed which address manufactured housing—all of which support reform of the Title I program. Three of the reports focus exclusively on manufactured housing, and two reports focus entirely on FHA Title I. The relevant pages from these reports have been provided to the Subcommittee electronically as appendices to this written statement. I will briefly describe each report and its relevant findings below.

The Millennial Housing Commission was a statutory bi-partisan commission established by Congress in 2000. The commission was charged with examining, analyzing, and exploring affordable housing programs in the United States and how they might be improved going forward. It submitted its report to this Committee in May 2002, as well as to the House Financial Services Committee and to the House and Senate Appropriations Committees. The recommendations contained in this report have served as a blueprint for housing legislation considered by Congress in subsequent years.

The report specifically covers the credit crunch currently prevalent in the financing of manufactured homes on leased land. On page 81 of the report, the Commission highlights the problem and recommends that "FHA's Title I and II programs be promoted and loan limits be increased; and Ginnie Mae approve more lenders as issuers/servicers, or instruct current issuers to make and service loans for manu-

factured homes." S. 2123 embodies the recommendations made in the Millennial Housing Commission report.

Later in 2002, the Neighborhood Reinvestment Corporation in collaboration with the Joint Center for Housing Studies at Harvard University issued a report to the Ford Foundation. The report, dated September 2002, was entitled "Manufactured Housing as a Community and Asset Building Strategy." One of the authors of this report is former FHA Commissioner William Apgar, Senior Scholar of the Joint Center for Housing. Mr. Apgar served as HUD's FHA Commissioner from 1997–2001 and has a unique perspective of the FHA Title I program as its former regulator.

The Ford Foundation report points out that unlike the beneficiaries of multifamily programs, owners of manufactured homes who do not own the land upon which the home sits do in fact build home equity and accumulate wealth. This is due to basic principle pay down in their monthly payments. These homeowners also benefit from homeownership tax breaks—mortgage interest deductions and property tax deductions—which are not available to renters. These factors are pointed out on page 9 of the report under the heading "Affordable Rental Housing."

Not surprisingly, the report mentions that land ownership is a key driver of home price appreciation. However, it goes on to say (top of page 9) that "the absence of land acquisition costs makes manufactured housing on leased land an affordable home ownership option to lower-income people." The report notes that increased privacy, greater access to land, and reduced financing costs make owning a manufactured home on leased land a reasonable alternative to multifamily housing for lower income families. Under the heading "Limited Sources of Mortgage Capital" found on page 14, the report states that "FHA and HUD need to allocate more staff and resources to explore options for supporting this segment (that is FHA Title I) of home ownership." S. 2123 embodies the recommendations made in the Ford Foundation report.

In 2003, HUD began to explore reform of the Title I program. In an effort to research both the need and the methods to reform the program, it retained the services of an outside contractor, Frontline Systems Inc., to prepare a comprehensive program analysis. Frontline Systems submitted its report to HUD entitled "FHA Final Title I Business Process Improvement Report" in June 2003. This report found that the Title I program was in dire need of modernization and made several policy and operational recommendations to HUD including: Raising the Title I loan limits; modifying current underwriting guidelines; changing the insurance structure to the Title II insurance model; and increasing lender participation. S. 2123 embodies these specific recommendations made in the Frontline Systems report.

As a follow-up to the Frontline Systems report, in 2004 HUD contracted for a second Title I study with another outside contractor, Information Engineering Services Inc (IES). This study was intended to drill down and build upon the Frontline Systems report by suggesting additional statutory, regulatory, and administrative (handbook) recommendations. IES submitted its report to HUD entitled "Title I Program Findings and Recommendations" in July 2005. Consistent with the findings of the earlier Frontline Systems report, the IES report made several recommendations for reform and modernization of the Title I program. These recommendations include: Changing the existing insurance structure to mimic the Title II structure; raising the loan limits and tying future increases to CPI; modifying underwriting standards; and updating the perception of manufactured housing and understanding the role it plays in affordable housing. S. 2123 embodies specific recommendations suggested in the IES report.

All four reports outlined above not only make the case for Title I reform, but also each report contained specific suggestions for improving this program. As pointed out, S. 2123 is not an original body of thought. Rather, it contains the suggestions of independent public policy experts, academics, former Members of Congress, and Federal housing regulators who have studied this program and have concluded it is in dire need of reform.

Conclusion

As Members of this Subcommittee are well aware, the homeownership affordability crisis in the United States has reached epic proportions in recent years. Land appreciation has driven homeownership beyond the reach of countless low- and moderate-income homebuyers across the country. While the FHA Title I program is largely immune from these problems due to the absence of land from typical transactions, it is subject to problems of a different sort. The outdated insurance structure, inadequate financial controls, and artificially low loan limits have all conspired to atrophy this program.

Congress, working together with HUD and the manufactured housing industry must reform this much needed program now. Material prices for home building have

increased more than 20 percent in the past 5 years while the loan limits have remained unchanged since 1992. Implementing the necessary reforms outlined above will give lower-income homebuyers the opportunity to enjoy one of the most efficient forms of housing available today.

PREPARED STATEMENT OF KEVIN JEWELL

CONSULTANT, MANUFACTURED HOUSING PROJECT
ON BEHALF OF THE CONSUMERS UNION

APRIL 4, 2006

Thank you Chairman Allard, Ranking Member Reed, and Members of the Subcommittee. My name is Kevin Jewell. I am speaking on behalf of Consumers Union. We are pleased to have the opportunity to share with you our research on the manufactured housing industry as it relates to the FHA Manufactured Housing Loan Modernization Act of 2005.

Since 2001, the Consumers Union manufactured housing project has been exploring a fundamental question: Does ownership of a manufactured home present families with the same benefits that puts conventional homeownership in a special part of the American Dream? Our answer: No. The promise of low-cost, factory-built housing all has been besmirched in real life by a market wrought with failure.

Conventional homeownership allows families to invest in an asset that historically has presented fairly stable positive returns for families. Stability of tenure strengthens communities, and investment results have historically build assets for families of all income ranges.

Why hasn't manufactured homeownership had the same sweeping success? The sales and financing process is ripe with abuse and variable product durability, warranty service, and code enforcement that contribute to a buyer-beware marketplace. Land tenancy for home-only units can be tenuous, leaving consumers at the mercy of the whims of landlords. Over time, manufactured homes without land general lose value. (See Consumers Union's "Raising the Floor, Raising the Roof" for further discussion of these challenges. This report is available online at: *http://www.consumersunion.org/pdf/mh/raising.pdf.)*

The bill before you (S. 2123) lies at an uneasy nexus of policy interest. On one hand, it facilitates the sale of a product that has yet to overcome its significant market problems. The home-only loans allowed by the bill will put the many homeowners in a depreciating asset, on a long-term note, but with a short-term lot lease. In these cases, homeowners will find their investment lives at the whim of a landowner. Here, we find we are encouraging families to make a purchase without stability or investment potential.

We cannot expect the benefits of community or asset accumulation in this situation.

On the other hand, this bill, with modification, could facilitate an appraisal-based chattel product that the private market has failed to provide. Reasonable loans on true inspected, installed, appraised values would be an improvement on loans on inflated values that have been all to common over the last decade in this industry.

But significant changes are needed for the potential benefits of this product to outweigh the problems in this industry. A purpose of these proposed changes is to bring stability to this marketplace. As an insurer, it is in the government best interest to bring stability to this market, but it is also in the public interest for FHA to avoid setting up borrowers for loans with a high probability of failure. A family with a failed loan is worse off then before the purchase.

Consumers Union suggests that this program be altered to remove eligibility for home-only loans in situations where the homeowner cannot demonstrate control of the land upon which the unit sits. Without control of the land, the homeowner and the lender lie at the whim of the landowner, and invites loan failure. In high loan-to-value loans such allowed under this program, equity builds slowly in a depreciating asset. Our analysis indicates that the equity balance in even the larger FHA Title I loans would be such that it would not be worthwhile for a consumer to spend the cost of moving a home for 5–10 years after purchase. If rent was increased unacceptably, or a park was closed, it could be in the consumer's best interest to send the home back to the bank and walk away from the deal. This would also push most families to bankruptcy or and exit from the mainstream financial marketplace.

Control of the land does not have to be ownership, although that is the most common and conventional path for control. Co-op ownership has had success in New Hampshire. Freddie Mac has experimented, although with limited success, with a

"leasehold" program. In the Freddie Mac program, buyers enter into a transferable lease that codifies rent increases and other rules for 5 years past the term of the loan. At minimum, FHA should require 5–10 year transferable leases for the home-only loans it makes. Until the equity in the loan matches the relocation cost, the borrower and insurer are at whim of the landowner.

Extending to FHA Title I insured personal property homeowners the consumer protections enjoyed by real-estate homeowners is another important opportunity to create stability in this marketplace. The stability these protections offer the real estate market are an important reason for the historical success of that market.

Personal property loans are generally subject to State repossession rather than State foreclosure laws. Insured loan contract language could explicitly incorporate the right to cure and antideficiency balance language found in foreclosure statutes into insured loan contracts. RESPA protections, such as good faith estimate of costs and kickback prohibitions, would place Title I personal property retail installment contracts closer to par to real estate loans and rebuild trust in this market.

The lot product in the Title I program has potential to benefit consumers by allowing them to escape a rental situation. The home and lot product offers little benefit over a Title II real estate loan, but properly implemented the home and lot product could expand lender options in limited situations. In manufactured housing, even more than in conventional housing, the details matter. It takes a good loan and purchase transaction for manufactured homes to have a chance for asset-building and a successful homeownership transaction. More detailed commentary on this and other language in S. 2123 have been submitted in my extended comments.

But the lot and lot-and-home products are of secondary in this debate. Without additional protections insuring tenure and clean transactions, this program has the potential to facilitate, even incentive, further failed loans in the marketplace.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM BRIAN MONTGOMERY

Q.1. Manufactured homebuyers, who often have few resources and cannot afford to purchase a site-built home, are vulnerable to subprime lenders who charge excessive interest and predatory fees. How will S. 2123 allow FHA loans to compete with subprime lenders who offer relaxed underwriting standards?

A.1. "Relaxed underwriting standards" come with a price, and that is built into the interest rate and the fees associated with subprime lending. By contrast, S. 2123 modernizes the Title I manufactured housing program in such a manner that lenders will be less likely to need a subprime outlet for their manufactured housing lending activity.

Several factors will make the FHA product especially attractive for lenders and consumers, including an assurance that FHA will pay insurance benefits in the event the borrower becomes unable to make payments. In addition, FHA will develop underwriting guidelines that are appropriate for this type of housing to reduce risk to the lenders, borrowers, and FHA. The projected reduced cost to the consumer, as well as the ease with which the loan officer and lender can qualify the borrower, translates into less need for the high interest rate subprime loan.

Q.2. Manufactured homeowners who finance with personal property loans do not have foreclosure protections. What safeguards do you foresee S. 2123 providing for these owners?

A.2. By modernizing and restructuring the Title I program for manufactured housing, FHA believes that a major component to foreclosures will be eliminated, that being the high interest rates typically associated with these loans. High interest rates create a vicious cycle: Borrower payments are excessive, thus increasing the likelihood of default and repossession, and lenders feel compelled to keep rates high to cover expected losses and collection difficulties.

S. 2123, if enacted, should result in a substantial reduction in interest rates thus increasing affordability and reducing the likelihood of default. While S. 2123 in and of itself does not provide any additional safeguards to foreclosure, by establishing an individual loan review process and by FHA enhancing its underwriting requirements, it will result in a reduced likelihood of foreclosure by assuring that these borrowers are likely to be able to make their payments in a timely manner.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM KEVIN JEWELL

Q.1. What safeguards could be added to S. 2123 to ensure that consumers of manufactured housing are protected from predatory lending practices, from owing more on their home than the home is worth, and from having to leave their homes due to an eviction on leased property?

A.1. Language can and should be added S. 2123 to protect new homeowners, and the FHA, from the factors in the manufactured housing marketplace that lead to high rates of loan failure in manufactured housing loans. Much of the testimony in support of

S. 2123 has focused on the successful outcomes that manufactured housing can offer buyers. It is important that greater attention is paid to the risks facing buyers insured under the FHA Title I program. It is these risks—equity stripping loan structures, repossession with deficiency balances, and tenuous tenancy—that increase the likelihood of loan failure for homeowners who choose home-only manufactured housing as their housing option.

Loan failure hurts not only the families buying homes under this program, but also the program itself. Unfortunately, this program is structured as an insurance product, and insurance products only pay out in the worst outcomes. To fashion a successful program for both families and the insurer, it is specifically the "worst case" risks that lead to loan failure that have to be addressed.

To address the threat to family stability posed by short-term lease structures, S. 2123 should add language specifically requiring the homeowner demonstrate 5–10 years of transferable control of the land upon which the unit does or will sit and directing FHA to include land control in underwriting standards for the loan.

To address the threat to investment potential from predatory sales and lending practices, the closing process should demonstrate that consumers have had an opportunity to make an informed decision to enter into the purchase contract. Home-only loans are not considered real estate loans for the purpose of many statutory consumer protections. This allows the closings of these loans to sidestep important consumer protections, such as those contained in the Real Estate Settlement and Procedures Act (RESPA). Protections equivalent to those found in transactions covered by RESPA, such as requiring consumers receive a good faith estimate of costs 5 days prior to closing, prohibiting lender kickbacks, and requiring third party closings should be required in loans eligible for FHA insurance. These protections reduce the opportunity for high pressure closings and increase the quality of the loans covered.

To reduce the likelihood consumers will get caught "underwater" on a loan, owing more on the home than the home is worth, language should be added to S. 2123 specifically directing the appraisal standard to be based on the installed, inspected market value of the insured unit at the site of demonstrated control. Mr. Frenz's testimony referencing GNMA's experience that the market value of manufactured homes is less than the appraised value gets directly at past appraisals to reflect to market value of the home in its final location. The Loan-to-Value calculations underwriting the loan should be based on the market value of the actual home as installed, not a hypothetical home on a dealer's lot. Implementing this standard requires more than a note from the owner stating the home is installed, as is all is required under the current Title I program. The home should be inspected and appraised by licensed professionals after installation.

Language should also be added restricting the program to used units. This will provide two benefits: It will avoid the effect of "unwrapping" depreciation on units covered under this program, (The "unwrapping effect" is the initial loss in value once a home is moved off the dealers lot and declared "used") and will reduce this effect for current homeowners by increasing the availability of credit in the second hand market.

Last, the 2.25 percent cap on the initial loan premium should be reduced, and by no means increased, as this capitalized initial loan premium eats directly in to the homeowners' initial equity. If, despite this negative effect, any increases are made to the capitalized premium amount, it is imperative the entire capitalized premium is then included in the principle amount used in the 95 percent LTV calculation. Otherwise, the program will put all participants underwater from the very start, setting the loan up for failure.

The goal of a successful homeownership program is not to increase homeownership in this country by putting families in loans with a high probability of failure; a successful homeownership program should place families in homes that provide an opportunity for stability and asset accumulation. While significant challenges prevent manufactured homes without land from offering these benefits to families, the changes to the program we have suggested here can improve the stability and investment value of homes bought with loans insured under the Title I program.