

**THE EXPANDING AMERICAN HOMEOWNERSHIP  
ACT OF 2007: H.R. 1852 AND RELATED  
FHA MODERNIZATION ISSUES**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
HOUSING AND COMMUNITY OPPORTUNITY  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED TENTH CONGRESS  
FIRST SESSION

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**THE EXPANDING AMERICAN  
HOMEOWNERSHIP ACT OF 2007:  
H.R. 1852 AND RELATED  
FHA MODERNIZATION ISSUES**

**Thursday, April 19, 2007**

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

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

Present: Representatives Waters, Cleaver, Green, Clay, Maloney, Sires, Ellison, Wilson; Biggert, Miller of California, Capito, Garrett, and Neugebauer.

Also present: Representative Frank, Ex Officio.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Today's hearing is entitled, "The Expanding American Homeownership Act of 2007: H.R. 1852 and Related FHA Modernization Issues." Without objection, all members' opening statements will be made a part of the record.

We will be recognizing subcommittee chairs and ranking members for, I think, 5 minutes each, and there will be an additional 5 minutes that will be given for recognition on both sides of the aisle. With that, I will recognize myself for the first 5 minutes.

Good morning, ladies and gentlemen. I want to thank Ranking Member Biggert for joining with me to hold today's hearing. Many members are anxious to see this bill move through the House, and I certainly am one of them.

The bill introduced by me, and cosponsored by Chairman Frank, will revitalize the Federal Housing Administration (FHA), once the preeminent provider of mortgage insurance to low- and moderate-income families in the country. I believe that this FHA legislation is critically important to bringing stability to the mortgage lending market, particularly at the lower spectrum of the market.

Everyone now knows about the perils of the subprime lending market with the dramatic rise in foreclosures and estimates that as many as 2 million mortgage loan defaults are predicted by year's end. So the sooner we can reinvent FHA to become a viable FHA, the sooner we will be able to assist many low- and moderate-income borrowers who are left with few safe and viable mortgage op-

tions. Refinancing, reverse mortgages, and other FHA products are all important.

Specifically, H.R. 1852 will facilitate the modernization of FHA and bring it into the realities of the housing market in the 21st century by: increasing loan limits in high-cost areas of the country like California, where the median price of a home in Los Angeles is \$513,000, and New York and Massachusetts, where FHA has been driven from the market forcing many borrowers to turn to high-cost financing and other non-traditional loan products; authorizing zero down and lower down payment FHA loans for home buyers who could not otherwise make the down payment required under current FHA rules to make FHA more consistent with other private sector loan products, especially where the borrower has a strong record and credit history; directing FHA to underwrite to borrowers with higher credit risks than FHA currently serves that are still credit worthy to take out a mortgage loan but who have been otherwise driven into the subprime loan market with pre-payment penalties, ARMs, and ultimately unbearable mortgage interest rates that are leading to foreclosures; and permanently eliminating the current statutory volume cap on FHA reverse mortgage loans to permit FHA to meet the growing needs of home equity rich and cash poor seniors and Baby Boomers who will need help paying bills or home costs.

In addition, H.R. 1852 includes a number of important changes to the FHA bill that passed the House last year. First, it eliminates the fee increases from last year's bill for borrower who continue to make a down payment, scaling back the maximum up-front fee from 3 percent to 2.25 percent and the maximum annual fee from 2.2 percent to .55 percent. These reductions will reduce FHA closing cost premiums for a hypothetical family buying a \$300,000 home by \$2,250 in annual fees over a 5-year period of \$20,000 compared to last year's bill.

The bill also adds a number of home buyer protections not included in last year's bill for families taking out riskier zero-down payment loans and for borrowers who represent a higher credit risk. The bill gives HUD the authority to require pre-purchase counseling for riskier borrowers, requires a number of disclosures spelling out the costs and risk of zero down and lower down payment loans, and provides the borrower opt-in to receive notice of availability of counseling in the event a borrower falls behind in their loan payments. FHA has very strong loss mitigation measures in place so the borrower protections in the bill are a plus that are widely supported.

Finally, the bill includes a provision authorizing loan limit increases for FHA rental housing loans in high cost areas where current FHA loan limits do not keep pace with local construction costs. I have said over and over again that there is an affordable housing crisis in America. I believe that the FHA modernization bill points us in the direction of a solution to help meet the housing needs of many Americans who still want to achieve the status of homeowner.

Thank you. I will now recognize the ranking member, Mrs. Biggert, for 5 minutes.

Mrs. BIGGERT. Thank you, Chairwoman Waters, and thank you for holding this hearing today. I would like to welcome today's witnesses, many of whom are not new to the subject matter, and I look forward to hearing their views. I am especially eager to hear from Assistant Secretary Brian Montgomery about how the FHA program may be of assistance in this current mortgage foreclosure crisis. We heard from him on this subject on Tuesday as well.

Clearly, the FHA has a role to play in the solution to this country's rising foreclosure rate. As Assistant Secretary Montgomery indicated in testimony before this committee and others, FHA is already assisting credit-worthy borrowers in need of loss mitigation and restructuring assistance. According to the testimony that he delivered at Tuesday's hearing in 2006, FHA assisted 75,000 families by preventing foreclosure through its loss mitigation program.

Moving forward, I am sure that Ms. Waters will agree with me that one of the most important things that this Congress can do as we search for ways to help those who have been harmed by the subprime market is to give FHA the tools it needs to be a viable alternative for first time and lower income borrowers. That is why this hearing on FHA modernization is both timely and critical. By modernizing FHA we can provide another alternative for low-income borrowers who may otherwise be forced into higher cost subprime loans or even predatory products. By moving quickly to modernize FHA, we can provide a safe alternative for hundreds of thousands of lower income credit-worthy borrowers looking to either purchase a new home or avoid foreclosure.

It is true that FHA cannot help all homeowners who are in the red, but it can help a good portion of them. Last month, both Chairwoman Waters and I introduced legislation aimed at reforming the FHA program. The bill that I introduced, H.R. 1752, is virtually identical to H.R. 1521, which passed the House by an overwhelming vote of 415 to 7 on July 25, 2006. H.R. 1752 is the same as the bipartisan compromise that was agreed to by Chairwoman Waters, Chairman Frank, and then-Chairman Mike Oxley in the last Congress. Given the overwhelming vote of 450 to 7, I had hoped that we could introduce the same bipartisan FHA modernization bill and move it expeditiously to the House Floor. The bill that I introduced incorporates all of the bipartisan agreements that were reached last year regarding how risk-based pricing and lower down payment requirements should be implemented. While the Frank-Waters bill implements some risk-based pricing and lowered down payment requirements, I am concerned that it will limit the flexibility that the FHA needs to serve additional low-income borrowers or to respond to ever-changing market conditions. That lack of flexibility translates into fewer borrowers being eligible for FHA assistance under the Frank-Waters bill.

Let me outline several of the differences between last year's bill, which I again introduced this year, and the Frank-Waters bill. First, the Frank-Waters bill permits only first-time home buyers to participate in a new low and no down payment loan program. My bill allows any FHA-qualified borrower to participate in the new FHA low loan program. Second, the Frank-Waters bill authorizes the FHA to implement risk-based pricing but it leaves in place the current outdated premium caps of 2.25 percent up-front and 0.55

percent annually. And the zero and lower down payment loans would have the higher caps. My concern is that these limits on premium caps will prevent FHA from serving riskier borrowers who could be prudently served by charging a slightly higher premium. With the flexibility to charge slightly higher premiums, FHA would be able to serve borrowers with the lower FICO scores who are currently being served only by the subprime market at very high interest rates. With FHA mortgage insurance, lenders will charge borrowers the market mortgage interest rate. Without FHA insurance, they have no choice but to turn the borrower away or to charge for a risk in an increased mortgage interest rate.

Just like last year's House-passed bill, my bill implements premium caps, and enables the FHA to reach down and serve riskier borrowers, but in a prudent manner. The up-front premium is limited to a maximum of 3.0 percent, and the annual premium to a maximum of 2.0 percent.

Third, my legislation includes another bipartisan agreement reached last year, the automatic reduction of annual premiums to no more than 55 basis points for loans that remain active after 5 years. Automatic premium reductions can be a good thing. They can reduce refinancing and perhaps some defaults and foreclosures as well. In contrast, the Franks-Waters bill requires the refund of excess up-front premiums charged to higher risk borrowers, those with FICO scores below 560. I am concerned that this provision could have unintended consequences of limiting the number of borrowers that could be served by the FHA program because it may require initial premiums to be even higher. The refund provision would also be very difficult to implement. It is inevitable in an insurance fund that lower risk borrowers will subsidize higher risk borrowers. Refunds of this nature undercut the concept of insurance and is the logical equivalent of a healthy person requiring a 100 percent refund of his or her health insurance premiums or a driver who does not get into an accident demanding his car insurance back.

If I could be yielded the 5 minutes, and then I will yield?

Chairwoman WATERS. Without objection.

Mrs. BIGGERT. Thank you. Finally, the most significant difference between the bill I introduced and the Frank-Waters FHA reform proposal is of greater concern to me and many of my colleagues and that is the inclusion of a provision that creates a funding place holder that envisions using FHA funds to support the creation of a national housing trust fund. While the other provisions that I have mentioned are the ones that represent significant differences between our introduced bills, using FHA program funds to create a housing trust fund is the most objectionable, and I believe that it is not an appropriate use of FHA funds. Taking funds out of FHA and using them for a purpose unrelated to its core mission would threaten the solvency of the FHA fund and its ability to pay out on insurance claims.

There is general agreement on the need for FHA modernization legislation. Furthermore, there is no doubt that the FHA program can be an important tool for the lower income borrower. The legislation that passed the House last year and was supported, again by both Chairwoman Waters and Chairman Frank, would make

FHA more efficient and competitive with subprime industry by decreasing premiums for borrowers, permitting no down payment loans, and increasing access to ownership. Removing the housing trust fund provision will allow us to work together on a bipartisan bill that can be moved expeditiously to the House Floor and that will receive overwhelming bipartisan support. We can even put it on the suspension calendar. The quicker we pass FHA reform in the House, the quicker we can send it to the Senate, and get it onto the President's desk, and I think relief is needed now.

I want to commend Chairwoman Waters for her timeless efforts last Congress to pass FHA reform legislation by such an overwhelming bipartisan vote, and I look forward to working together to again achieve this goal. Again, thank you for holding this important hearing, and I look forward to hearing the testimony today from our distinguished witnesses.

And I will yield. How many minutes do I have left?

Chairwoman WATERS. You have about 2 minutes.

Mrs. BIGGERT. Okay, I will yield 1 minute to Mr. Miller and 1 minute to Mr. Neugebauer. The gentleman from California.

Mr. MILLER OF CALIFORNIA. Thank you. It is good to have you here today. We are looking at a situation in the marketplace where we need to utilize every tool we have available to provide options for people to acquire a home. In areas such as California, we have an FHA program that has been available for 70 years. And if you look at the drop in utilization in California because we are a high cost area, it is really stunning. In 2000, FHA insured 109,074 mortgages in California. In 2005, it was 51,037. In my district alone in 2000, we had 7,000 mortgages. It dropped to 80. You are looking at a 99 percent drop in an area that arguably needs the benefit of an FHA program or a conforming program as much as any other State in the Nation does. In fact, in high cost areas it is much harder for people to get into—is my minute up? Thank you very much.

Chairwoman WATERS. I think you have 1 additional minute, Mrs. Biggert. Who did you yield that to?

Mrs. BIGGERT. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Well, thank you, Madam Chairwoman and Ranking Member Biggert. I think this is an important discussion we are having. We have been having a lot of discussions about subprime lending and making sure that we do not impact the marketplace with actions that we take here in Congress, certainly making FHA more relevant is a very important piece of policy that we are considering. Homeownership is at an all-time high. We need to continue to provide the ability for folks to do that, to experience the American dream.

I am concerned about a couple of things, one in the new bill is I want to make sure that we make available, being able to participate in FHA programs a broader spectrum and making it less onerous for some of our mortgage brokers to participate in some of the requirements that we are putting on them. In our previous bill, we had some provisions in there to make it easier. And then the second piece of it is we need to make sure that this new program is actuarially sound. We do not need to be going down a road where we jeopardize the integrity of the FHA program. And one of the

things that was mentioned is it looks like we are going down the road now of another extortion from an organization for money for purposes other than what that organization is proposed and chartered to do. And creating other funds and taking money out of FHA when we are embarking down a road of a new program, I think, is a very dangerous precedent.

Thank you.

Chairwoman WATERS. I recognize the gentleman from Massachusetts, Chairman Frank, for 5 minutes.

The CHAIRMAN. Thank you, Madam Chairwoman. I work with my friend from Texas on a lot of issues, and there are a lot of areas where this committee can cooperate across party lines, but nowhere have the differences that do exist between the parties been made more clear than in his last statement when he described the effort by the gentlewoman from California and myself to provide more funding for affordable housing as "extortion." The FHA is a Federal agency created by Federal law. And the notion that it is "extortion" to try to use some of the surplus funds it has been generating to help provide affordable housing greatly defines the difference between the parties.

I noticed that the gentlewoman from Illinois—who temporarily had to leave and who has been a very constructive member also—said, "Well, we should not be using FHA funds for other purposes." Maybe she missed this, but during the entire period of Republican majority rule, that is exactly what was happening. The FHA was producing surpluses which went into the general treasury, and they have been used to support such non-housing related issues as the war in Iraq, nuclear testing, or anything else the Federal Government does. This notion that money should not come from the FHA for other purposes is a very new one because the FHA has been a money maker for the rest of the Federal Government in the past. Now it is true that many of us—including the gentlewoman from California and I—believe that if the FHA continues to generate surpluses, and we certainly will guarantee that first claim on any monies goes to keep the FHA functioning, but the question is should the surpluses go into the general treasury and help offset everything else the Federal Government does, such as farm subsidies, the war in Iraq, bridges to nowhere, and all of those other purposes for which it was put, or should we target it towards affordable housing?

The gentlewoman from Illinois also expressed surprise, and to some extent disappointment, that the gentlewoman from California and I have a different version of the bill than the one that passed last year. And the gentlewoman from Illinois correctly noted that last year the gentlewoman from California and I supported a different version of the bill but, again, maybe she forgot something happened in the interim: the election. The gentlewoman from California and I are strongly committed to trying to help homeownership, to bring down costs for housing in general, and to help the middle class, but also to do something about that very significant fraction of our population who are not adequately housed, and who that pay too much for housing. Last year we did the best we could, we were not in the majority. We were being constructive. In fact, I think you could say we were setting a good example for our

friends. When you are in the minority, you recognize that you are not going to write the major pieces of the bill and you cooperate to get the best deal you can. That is what the gentlewoman from California and I did. I know there have been people who have been surprised that we have not lived up to their stereotypes and that we have, in fact, been cooperative and conciliatory given the circumstances. Things are different now. And there are a lot of things that the parties have in common, but we have always had the view that we should be reaching out to help people who are in economic distress and now that we represent the majority, we plan to do that.

And let me talk specifically about the terms under which the FHA would be lending to people with more credit risk. Yes, the bill that we are supporting says that if you or someone with higher credit risk and a lower credit score borrows the money and diligently pays it back, you should not, in the end, be charged more by your own Federal Government than someone making 3 times as much money as you. That is the radical proposition which we are advocating. We recognize there is a risk, and we said, okay, there will be some higher up-front premiums. But we say that if you meet your obligations, if you work very hard and pay back what you owe, why should you pay more than somebody who makes far more money than you because other people in your situation previously defaulted?

Now the gentlewoman said, "Well, that rule was strict, what is available?" No, only if you consider the higher credit risk people to be a closed pot. I, along with the gentlewoman from California, have been preaching, and I think finally we are going to win and we are going to admit California, Massachusetts, and New York to the Union. We are going to allow them to fully participate in Federal housing programs: FHA, Fannie Mae, and Freddie Mac. They have been somewhat excluded for some time. That will generate some revenues, and we intend to take some of the additional revenues generated within this set of programs and use them to make the radical proposition—that if you are of a higher credit risk and you borrow money and you get your mortgage insurance from the FHA and you pay back every penny you were supposed to, that you will not be charged more by your own Federal Government—true. That is the best thing we can do about the subprime market.

And there was also a comparison to insurance. Well, this is the Federal Government. I do not think that the Federal Government ought to—I know there is a dispute about whether or not we should help the poor at the expense of the wealthy but is there really an argument that we should penalize lower income people by charging them more for exactly the same mortgage insurance as someone who makes 3 times as much because somebody else who makes the same amount they do did not pay it back? So, yes, that is what we are saying. We are saying that if the FHA is to generate surpluses, as it has for 12 years, rather than that money going for earmarks in the agricultural surpluses and wars and trips and other things, it should be recycled to some extent for affordable housing, which does help everybody as you add to housing. One of the problems we have had is a housing program whereby we have only done vouchers so we have added to the demand for

housing without increasing the supply. And we also believe that in dealing with people in the subprime category, we should extend to them the ability to go to the FHA and be helped. And if they make their payments like anybody else, they should not be charged more than anybody else.

I thank the gentlewoman for her leadership, which has been so strong in this area.

Chairwoman WATERS. Thank you very much, Mr. Chairman. All time has been exhausted on both sides. We are going to move to our panel. On our first panel we have the Honorable Brian D. Montgomery, Assistant Secretary for Housing, Federal Housing Commissioner, U.S. Department of Housing and Urban Development. Welcome, Mr. Montgomery.

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

Mr. MONTGOMERY. Thank you very much, Chairwoman Waters, Chairman Frank, and Ranking Member Biggert, for inviting me here today to testify about the modernization of FHA. I want to begin this morning also by thanking not only just both of you, but again Chairman Frank and Ranking Member Bachus, for your strong leadership on this issue, and that goes for the entire committee as well for allowing me to testify on how best to fix FHA.

Yes, last year, our hard work, our collective hard work paid off to the tune of 107 cosponsors. They were evenly split between both sides of the aisle. Yes, and a resounding 415 to 7 vote on the Floor of the House. Well, this year, as we all know, we have two bills pending before this committee. Both bills would raise loan limits in high-cost areas. They would eliminate FHA's antiquated down payment requirements. And they would allow, to varying degrees, risk-based pricing to occur and eliminate the burdensome cap on reverse mortgages. Yes, we look forward to working with this committee on a bipartisan basis like we did last year in helping craft a comprehensive bill that would provide underserved Americans with a safe mortgage at a fair price. And speaking of fair price, when borrowers pay FHA insurance premiums, they are essentially buying a prime interest rate. An FHA-insured loan is generally 3 to 4 percentages lower than a subprime loan. When comparing these two loan types on a \$225,000 mortgage, this rate differences translates into an average savings of \$300 a month. That is \$137 over the life of the loan.

In recent years, the primary users of many subprime loans have been minority and lower income first-time home buyers, many of whom struggle to qualify for prime loans due to underwriting or down payment requirements. It is our belief that had FHA had a minimum, and I say a minimum, amount of flexibility like that proposed in the FHA modernization, we could have better served many of these borrowers. The impact on African-American and Latino borrowers has been particularly profound. For instance, according to our 2004 numbers, 40 percent of African Americans and 23 percent of Latinos pay an interest rate 3 percentage points higher than market rate.

As you all know, the volume of subprime lending is declining rapidly. While this may appear to be good news, the departure of a strong subprime presence means many lending institutions may turn their backs on lower income borrowers. In order to offset this thinning of credit, there needs to be a mortgage alternative we like to call, "Back to Basics," which would provide a wide swathe of lower-income borrowers with the credit and loan options they require, and that is a modernized and reinvigorated FHA.

As I mentioned before, we are seeking the following changes. First, we are proposing to eliminate our complicated down payment calculation and 3 percent minimum cash investment requirement. Second, our proposal seeks to provide FHA the flexibility to set insurance premiums commensurate with the risk of the loans. In so doing, we could reach deeper into the pool of prospective borrowers while protecting the financial soundness of the FHA mortgage insurance fund.

Lastly, I would like to mention the proposed increase in FHA loan limits. By increasing the loan limits to 65 percent and 100 percent of the conforming loan limit, which we support, FHA would once again be a player in high cost areas, regions that have previously been out of play, such as the entire State of California and most of the Northeast. What is more, raising the floor to 65 percent of the conforming loan limit has the added benefit of giving families better access to newly constructed housing, which is on average more costly.

Finally, before closing, I would like to take a moment to assure you of FHA's readiness to proceed. Regarding our capacity to manage our book of business, the inspector general recently completed its annual audit of FHA's financial statements. In short, we received a clean opinion. In fact, this marks the 14th consecutive year of clean audits. However, it is the first in which absolutely no material weakness were identified, that it never happened. What this means is that when FHA reports on its financial position at the end of each year, the reports are accurate and fairly portray the financial status of the FHA mortgage insurance fund. With such a long history of success, and the continual improvements to our processes, I am not sure why some people question our ability to manage the FHA funds. And in light of the recent GAO report taking us off the high-risk list for the first time since 1994, there should be no doubt—no doubt—that we can manage our programs. If we were not fiscally sound, trying to implement change would spell disaster but this GAO report, as well as our most recent audit, reveals that FHA is both financially stable and consistent.

In conclusion, I believe that FHA should continue to play a key role in the national mortgage market, and I am here today to make the case for changes to the National Housing Act that will permit us to continue to fulfill this critical mission.

I want to thank you again for providing the opportunity for me to testify today.

[The prepared statement of Mr. Montgomery can be found on page 65 of the appendix.]

Chairwoman WATERS. Thank you very much, Mr. Montgomery. I recognize myself for questions for 5 minutes. As has been said over and over again, and as was said by Mrs. Biggert this morning,

we did a fantastic job of getting bipartisan support for FHA modernization in the last session of Congress, and I am looking forward to cooperation from both sides of the aisle so that we can move this legislation and open up opportunities for people who have been thrown into the subprime market and who find themselves certainly in great difficulty now.

I have heard some of the concerns that were registered by Mrs. Biggert, which I suppose caused her to want to carry a bill to make sure those concerns were addressed. Do you agree that we need to do anything differently than we did in the last bill? If so, what? And I would like for you to specifically comment about our housing trust fund and this legislation.

Mr. MONTGOMERY. Thank you. Let me discuss the trust fund first. To be honest, we do not know enough yet about how this trust fund would be structured, where the funds would go. I, speaking for FHA, have IT system requirements as the world's largest mortgage insurance company, government mortgage insurance company, and the world's largest mortgage company for minorities. I would like to be able to have the ability to get professional staff that would enable us to carry out our mission, especially in a reformed FHA, and to be able to pay them similar to other government agencies do. So speaking selfishly for FHA, I could use those funds to help do some of what I just articulated. So I will say until we know more about how the fund would be structured, I certainly appreciate the concept, and am very sympathetic to the concept, but until we know more about it, it would be difficult for us to say that we would wholeheartedly support it.

Chairwoman WATERS. Do you agree that there is a housing crisis?

Mr. MONTGOMERY. I have said publicly many times that there is a housing crisis in this country, and I have said publicly in other settings, in particular for persons with disabilities and for the elderly.

Chairwoman WATERS. Do you agree that FHA modernization could open up opportunities for many folks who could not be serviced or who get thrown into a subprime market that places them at great risk?

Mr. MONTGOMERY. Absolutely.

Chairwoman WATERS. Do you agree that it is important that this bill moves without any obstruction so that we can have a reformed FHA?

Mr. MONTGOMERY. If I could respond to that, and also to your first question as to the differences. Under the premium structure, Madam Chairwoman, that you have versus the Biggert bill, by having a cap of 2.25 percent versus a cap of 3 percent, that precludes us from being able to help lower income, higher risk borrowers because of the actuarial requirements of the mutual mortgage insurance fund. While I can understand why you would have your cap, and Mrs. Biggert has hers, we would propose, and so support as we did last year, to have the maximum flexibility. And that is one of the reasons for some of the predicament that we are in on the subprime—to be able to go to 3 percent because as you heard me say previously, looking at the difference between FHA even at 3 percent, by the way, the difference between 3 percent—1 percent

and 3 percent on a \$225,000 loan is about \$26. And you heard me say with the subprime borrowers at 3 points above par, the difference on that \$225,000 home is about \$300 a month. So, again, we think by having the 3 percent, would some borrowers like that? It gives them flexibility. We can reach lower income, lower FICO score borrowers, including many subprime borrowers whom we cannot reach today.

Chairwoman WATERS. But we are going to agree that we are not going to let that difference stop this bill, is that right?

Mr. MONTGOMERY. I am sorry, ma'am?

Chairwoman WATERS. We are not going to let that difference get in the way of getting a bill passed and onto the President's desk?

Mr. MONTGOMERY. Well, since I do not have a vote in this process, I will let you all decide that. In all candor, Madam Chairwoman, everybody has worked so hard on this bill and that is the good news here. We all know we need to modernize and reinvigorate FHA, but we feel strongly that we need the ability to reach higher risk, lower FICO score borrowers and we can do that at 3 percent—more of them I should say, more of them than we can at 2.25 percent.

Chairwoman WATERS. Thank you, Mr. Montgomery. And I will recognize our ranking member, Mrs. Biggert, for 5 minutes for questions.

Mrs. BIGGERT. Thank you, Madam Chairwoman. Commissioner Montgomery, could you explain the importance of allowing FHA to assess the risk of each individual borrowers when setting mortgage insurance premium prices?

Mr. MONTGOMERY. Well, that is critical. We are an insurance company; we are in the risk business. We are in the business of helping lower income borrowers with little savings for a down payment and perhaps some blemishes on their credit. That is what we have done for decades now. But we take very seriously protecting the solvency in the FHA fund so we put each risk category through a rigorous test, through an actuarial review. Our Office of Evaluation conducts that. And it is critically important for us to be able to identify any number of different variables for all borrowers. By the way, that pool of borrowers that we have profiles that we can look at is some 4.5 million or so different risk profiles.

Mrs. BIGGERT. How does this type of price structure allow FHA to help more low-income borrowers?

Mr. MONTGOMERY. Well, as you heard me mention previously, well, let me add a little bit to that. Let's say the up-front premium is 1 percent on a \$225,000 house. Your payment for the up-front mortgage insurance is about \$14—\$13.90 and change. At 2 percent, you are at about \$26. And at 3 percent, you are at roughly \$39.95 or so. So the difference is not much. Now the \$225,000 figure in this room sounds like a low amount. But as Congressman Neugebauer from Texas knows, that is a big home in the South and in the Midwest and in other parts of the country. As a matter of fact, 75 percent of our mortgages currently are below \$150,000. And the average cost on average, the median for FHA, is somewhere around a \$130,000 mortgage. So the \$225,000 example is half that for the lower income—or the lower priced home.

Mrs. BIGGERT. If the bill that we had last year was enacted tomorrow, how quickly could you implement the reforms?

Mr. MONTGOMERY. Well, like we did last year, and we are doing this year, in some cases we are preparing for a victory party let's say that we may not have. I say that in that we cannot wait. Hopefully, we will get a reformed FHA bill through. We cannot wait until that moment in time to say, "What do we do now?" So we were meeting last year, and we have been meeting this year with our IT staff. We are prepared to make the changes to our underwriting system to what is called our total scorecard. And to begin, we also have been putting together what the training for lenders would look like. We would be ready on day one. We would be more ready on day two, but we will be ready on day one.

Mrs. BIGGERT. Okay. I understand that FHA has nearly the same delinquency rate as the subprime market but the foreclosure rate is much lower. Could you explain what tools you use between the delinquency or default and foreclosure and whether this accounts for the lower foreclosure rate?

Mr. MONTGOMERY. Well, the subprime market has a foreclosure rate twice that of FHA. And, yes, our 90-day delinquent rates are within points of each other. I think that the fact that our foreclosure rate is half points to your point and that is, yes, we have a very vigorous loss mitigation program, we require lenders to reach out and to work with borrowers who are in trouble and, yes, we saved 75,000 families last year—FHA-insured families from foreclosure. I think that point is more important today than probably at any point in the last several years, especially as we see many other families who have subprime products facing some financial crisis in their life.

Mrs. BIGGERT. How many additional borrowers could you serve if last year's House bill was enacted?

Mr. MONTGOMERY. Well, based on last year's bill, we expected our volume to essentially to double between now and 2012, not including the reverse mortgages, by 2012 we would be serving 1.2 million borrowers under FHA, about double what we are today.

Mrs. BIGGERT. How many people could you serve if nothing is done, if there is no change, and we do not have any modernization bill?

Mr. MONTGOMERY. Well, right now we are serving roughly 500,000 borrowers. As you know, our volume of business has been in a free fall for about 3 or 4 years. The good news is that, through some process improvements, we have sort of stopped the hemorrhaging, but we think again in Mr. Miller's State and others, the fact that they cannot use this product did not make any sense to us. That is why we want to improve it.

Mrs. BIGGERT. Is there a difference in how many people you could serve if the Waters-Frank bill was enacted versus last year's bill or the current situation?

Mr. MONTGOMERY. It would be more difficult at the 2.25 percent increase for us to serve borrowers with incomes less than \$45,000 a year and with FICO scores below about 600. Because of the actuarial review that we conduct and, yes, we are an insurance company, risk is our business, we would have to probably raise the cash investment on those types of borrowers above 3 percent.

Mrs. BIGGERT. Thank you. I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. Are there any other members who wish to be recognized for questions for Mr. Montgomery? Mr. Cleaver, in order of seniority unless you are not ready, then we will go to Ms. Maloney.

Mrs. MALONEY. I defer to him because he was here first.

Chairwoman WATERS. But he said it is okay.

Mrs. MALONEY. Okay. Well, first of all, I just want to really congratulate Chairwoman Waters and Chairman Frank for moving so swiftly on this, first going to the Katrina area and moving a GSC bill that is going to put some housing money out of the government into the ground to help the people. And really revitalizing the FHA program, the Expanding Home Ownership Act is part of the puzzle we need to help the predatory lending tsunami and making it available to people and really making it more flexible. There are ways that we could change it so that it is available and more flexible to people in need. And this bill goes a long way towards doing that. And I really cannot thank the chairwoman, the timing of it could not be more important to get this going forward, and to have had a bill with a fair and balanced approach.

One area in the GSA/GSE bill that Chairwoman Waters moved forward, Mr. Baker and I added daycare, which is in a crisis in this country. It is not there. People are opening up their homes for daycare, licensed daycare. In New York City, there is a waiting list of hundreds of thousands of people. It is not there and it takes a man and a woman to put the food on the table and pay the rent now and too often in American society. So both are working and we need more daycare. And I am going to be working on an amendment that would be part of FHA, expanding it in a certain framework, so that daycare loans and financing could be there in a flexible way not only for new construction but for homes that are going to have licensed daycare in it. That is the only daycare that is growing in New York is licensed daycare in their homes. And I would like the gentleman, if he could, to respond to this concept? We added it to the GSE bill as one of the areas that you can get secondary market financing. It is a creative way to get money into the system to help with this critical issue that is confronting families of America.

Mr. MONTGOMERY. Thank you very much for your question. Whenever I hear the word "daycare," my ears perk up because I have a 5½ month old at home. Conceptually, Congresswoman, certainly we would love to hear more about how your bill would work and certainly understand the plight of many lower income families and how they juggle both work and taking care of their children. We certainly look forward to having those discussions with you in that area.

Mrs. MALONEY. Secondly, on the subprime crisis that we are confronting, I think we all agree that preserving homeownership is just as important as expanding it. And what in your opinion, whether it is in this bill or through another vehicle, should Congress do to make sure that we help those people who are being affected by the current subprime crunch, many of whom were exploited, they were targeted? First of all, how do you think it could be incorporated in your bill or rather in Congresswoman Water's

bill to expand the way the FHA could help people restructure loans in crisis or any other ideas that we can have as we move forward to help people stay in their homes?

Mr. MONTGOMERY. The good news is that we are helping subprime borrowers today. As a matter of fact, we are on track this year to help people getting out of a subprime loan or refinancing into an FHA loan, we are on track to do conservatively about 60,000 this year with the existing FHA structure. Many families on their own obviously have figured out they are in a predicament and reached out to us for help. But we think the best way relative to refinancing is to have that latitude for people getting out of a subprime loan into an FHA loan, to have the latitude to go to a 3 percent up-front premium because these would be some higher risk borrowers.

Mrs. MALONEY. Well, specifically, one idea that I have, or one hurdle that is out there I have read about, is that some homeowners who would otherwise make good candidates with an FHA loan with a decent track record on time payments may be barred from refinancing with FHA if they are not current on their existing loan. Oftentimes, because they are suffering from the payment shock of the interest rate reset, jumping from the teaser rates to a higher level, do you think looking into changing this requirement might benefit homeowners and FHA if it could be done in a way that is responsible?

Mr. MONTGOMERY. Absolutely and that is something we are looking into today. I discussed at Tuesday's hearing, since it would present a new risk category for us, that the Credit Reform Act of 1990 requires us to put that new risk category, that would be delinquent borrowers but for the reset they had good credit let's say for the previous 12 months, we are looking at that right now.

Mrs. MALONEY. And, lastly, because my time is running out, could this change be done administratively by HUD or should there be a legislative fix for it?

Mr. MONTGOMERY. The Credit Reform Act requires that we put it through a stress test. We are doing that right now. And I would have that authority based on the outcome of the review.

Mrs. MALONEY. Okay, thank you very much.

Chairwoman WATERS. Thank you. Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Madam Chairwoman. Commissioner, I appreciate your being here, and I think the intent of this committee is to make FHA a more relevant factor in the marketplace. One of the concerns I have is when you were talking about flexibility a while ago, our financial markets are very sophisticated today. And one of the reasons I believe that your business is down is due to your inability to really respond to market conditions. I want to go back to the rate thing just a little bit. Now, it is my understanding if you initiate some of these new programs, those programs will be bracketed as a category and you will have to actuarially measure what your loss ratios are on these new types of products that you are putting out. And doesn't it make sense for you to have the flexibility to be competitive to be able to price those based on what your actuarial findings actually are?

Mr. MONTGOMERY. Absolutely, Congressman, I think the FHA Commissioner should have that flexibility.

Mr. NEUGEBAUER. And doesn't it also make sense that if in some cases, if those certain types of products that you are doing are actually performing better, you have the flexibility to actually lower those premiums, that if in some cases, those certain types of products that you are doing are actually performing better, you have the flexibility to actually lower those premiums, and obviously make them more affordable for some of our borrowers?

Mr. MONTGOMERY. Again, yes sir, we certainly agree, and in fact had the Commissioner, me, or whomever at the previous flexibility to adjust premiums, look at today, we are still discussing having that flexibility now almost a year to the day from last year's hearing. I suspect we could have helped a lot more lower income borrowers during that year period had we had that flexibility.

Mr. NEUGEBAUER. And I want to go back to a little bit of some things about, whether it is a housing fund, what we are talking about is retained earnings, we are talking about profits. What do you do—if FHA begins to make more money and stay on the same financial course, what do you do with the earnings? And if we are talking about distributing, I guess we feel like in some cases those are excess earnings. I have never made earnings in excess before but I would like to get to that point. But one of the things that I think is important is if you are managing an entity that is trying to move towards an affordable housing goal, doesn't it make sense then to be able to maybe make some investments internally within FHA and possibly give you the ability to create some new kinds of products and programs rather than having to worry about those monies being taken out arbitrarily from FHA?

Mr. MONTGOMERY. As I referenced earlier, if we had the ability to make some of the IT improvements, one of the programs that they use is computer languages that you and I probably had when we were in college that most people under 30 have never heard of—Fortran and COBOL. We have a fantastic CIO but we cannot be the priority in every category. And so, yes, there are some improvements that we need to make and it would be good to have the flexibility to do so.

Mr. NEUGEBAUER. You and I had this conversation, I think, when we were talking about the last bill, and that is that you depend upon the originators to go out there and to sell your product. While you can put the product together and you have something, the ability for FHA to expand their business is going to depend on, number one, the acceptability of the product, and number two, the availability of people to go out and originate those, is that correct?

Mr. MONTGOMERY. That is correct. We do allow and have brokers and lenders and other certainly sell our products so to speak, we require that.

Mr. NEUGEBAUER. And one of the things that is not in the new bill that concerns me is the fact that we had put a requirement, we had talked about allowing for some of the smaller originators to, rather than having to have an expensive audit, and we all know with today's environment, we have had a little dose of Sarbanes-Oxley, we know what the cost of these audits, they have skyrocketed. And for our small business people who want to have a little small mortgage business, that makes it a very difficult process for them. Would you support being able to look at an alternative,

a bond or something like that, for some of our smaller originators to be able to participate in your programs?

Mr. MONTGOMERY. We have had previous discussions on the bond and relative to the responsibility to protect the solvency of the mutual mortgage insurance fund, a surety bond, while good at the State level, doesn't give us a lot in that respect. But let me say though that I am very sympathetic, Congressman, for the mortgage brokers here, aware of that, to those small businesses. I go out and I attend their conferences, I travel a lot, I meet with mortgage brokers and when a small business, a father and son, a mother and daughter, or two sisters, whatever, who are mortgage brokers and love it, taxes say we do not make a lot but we cannot use the FHA product. It doesn't make any sense to me for a government program to be so onerous so that small businesses cannot use it. So we are where we need to be in that respect yet although we have discussions with the mortgage brokers and there are a couple of things that we have been discussing and ultimately we allow more mortgage brokers to use the program.

Mr. NEUGEBAUER. I think it is going to be imperative that we do that.

Chairwoman WATERS. Thank you, your time has expired. Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman, and thank you for scheduling this meeting and for having the initiative to push us toward transforming the FHA. Mr. Montgomery, like a lot of people, Baby Boomers at least, I came out of college and bought my first home with FHA, an \$18,000 home. And at that time, everyone I knew buying homes were going through FHA. I think it served its purpose well. And, of course, today in your testimony when you talked about the drop in the FHA share of the market in Chairwoman Waters' district, that just is mind-boggling. What I would like to ask or find out from you is Freddie Mac has said that they are going to buy up to \$20 billion in subprime mortgages. You cannot compete with the giants but is there a way, a possibility, for you to beef up your portfolio, is it possible for FHA to buy any of the subprime mortgages?

Mr. MONTGOMERY. Thank you, sir. As I mentioned here in this very room on Tuesday during the hearing, we are helping subprime borrowers today. You may have heard me reference earlier that we are on track to assist, we think, about 60,000 conservatively this year who are getting out of a subprime loan in FHA. With the reformed and modernized FHA, especially to have flexibility on the premiums, there is no doubt in my mind we can assist many more. Now that is not to say we are going to throw open the barn door so to speak. We have to protect the solvency of the Mutual Mortgage Insurance Fund so many families, all of whom, would still have to go through our eligibility and underwriting criteria.

Mr. CLEAVER. There is a lot of discussion going on about Freddie Mac, Fannie Mae, and the size of their portfolio, and it seems to me that the best way to reduce that portfolio to bring it into some kind of normality would be for FHA to increase its share of the market. If you had an opportunity to write on that sheet of paper with your left hand, what would be the best thing that could happen for FHA to begin to rise again what would it be?

Mr. MONTGOMERY. Well, certainly upgrading our IT systems and being able to pay some of our professional staff more. But as far as the retail thing, being able to help borrowers having the maximum flexibility on the up-front premiums and on the annual premiums would allow us to help higher risk, lower FICO score borrowers in an actuarial sound manner. And, again, we are helping many today and it is our strong belief we can help many more with a reformed, modernized FHA.

Mr. CLEAVER. But what could this committee do?

Mr. MONTGOMERY. Pass an FHA bill.

[Laughter]

Mr. MONTGOMERY. I normally don't get that question so I appreciate the efforts to try and pass the FHA bill.

Mr. CLEAVER. That is good. That is the best response. Is there a plan to increase multi-family loan fees?

Mr. MONTGOMERY. Relative to the OA budget, there is a proposal in there different from the proposal last year that was rescinded to increase in some instances the fees for, we are talking about multi-family here, to increase their insurance premiums. That will go out for public comment here in the next several weeks. It has not happened. I want to stress that. And please understand that we will put it out for public comment and be mindful of any comments that we receive.

Mr. CLEAVER. Thank you, Madam Chairwoman. I yield back the balance of my time.

Chairwoman WATERS. Thank you. The gentleman from California, Mr. Miller, for 5 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, I will take blame for the security bond language in last year's bill because I had it put in there. And I did it for a reason—mortgage brokers originate more loans than any other group in the marketplace out there. And yet if you look at the cost prohibitive, time consuming financial audits and net worth requirement, it limits brokers' participation in the FHA program. And you wanted a minimum amount of flexibility, which I think is an understatement, I want to give you a maximum amount, but in some of these areas where we are talking about instead of as some might transfer assets, we all know how this is done, you can transfer assets and make your audit look really good, assets disappear, in the construction industry, we have been required for years to put up surety bonds and it has worked very, very well. And if it is a cash audit or it is a surety bond for the given amount of money, which equates to the same, one is accessible if there is a problem, I do not understand why we would limit participation in a program that I will state from my area when it has dropped 99 percent in 5 years, you and I both look and say there is a severe, severe problem here. And when you look at the largest group of loan originators in this country and we say how do we also provide flexibility for them as we are trying to provide for you and with that flexibility safeguard the requirements so we are not saying, okay, just do it without any safeguard. But somebody is going to write a surety bond, I know people who write surety bonds and they do not go out there and arbitrarily write a surety bond without knowing they have something to go after if that occurs. So why do you think that we cannot structure a reasonable

approach to including more individuals to be able to work with FHA and provide an alternate such as surety bond?

Mr. MONTGOMERY. We are trying to find a reasonable approach.

Mr. MILLER OF CALIFORNIA. But you are willing to work? Okay, Maxine, you heard that, he is willing to work, so we need to look at this, okay. That is a good approach.

Mr. MONTGOMERY. Just on the surety bond there is no national standard for surety bonds, they vary from State to State. But I do want to stress again that we are very sympathetic—

Mr. MILLER OF CALIFORNIA. Well, that is why I have been fighting for optional Federal charters for the insurance industry because every State requires a different base, some allow third party insurers, some do not, so I do not disagree there, but if the bond is written in a fashion acceptable, I do not know why that would be precluded from the conversation?

Mr. MONTGOMERY. Well, in reference to your previous comment about being sympathetic and discussing with them other options, we are having those discussions as recently as several weeks ago with the mortgage brokers.

Mr. MILLER OF CALIFORNIA. Okay, so let's say that is still on the table and we can still do that. If you look at the situation we are facing in the mortgage market today, I think it is profound how we need to reform FHA. What are the benefits FHA—do you think an FHA program has over other options that might be available in the marketplace today?

Mr. MONTGOMERY. It is a back-to-basics approach. We have never had anybody call our toll-free number and say, "I do not understand my FHA loan." Your first payment is equal to your last payment, no pre-payment penalties, no teaser rates, no hidden costs. The benefits are far more than what some of these other loans—

Mr. MILLER OF CALIFORNIA. So you think the FHA can really complement the private sector in providing a broader base for your project to be applied?

Mr. MONTGOMERY. Well, we are a government mortgage insurance program that works in partnership with lenders, originators, and brokers. To me it is the best of both worlds. You have a private delivery system and the beauty of a government program with a 73 year track record.

Mr. MILLER OF CALIFORNIA. And so if we are going to do something that could likely double the business you currently generate let's say, which we think you are being held back tremendously, a very safe program, it works, it's beneficial, there is really no reason why we shouldn't include the largest originator of loans, and that is the mortgage brokers, in your program and be somewhat flexible, yet provide safeguards on how they apply your program and are involved in it, would you not say there are options for us there?

Mr. MONTGOMERY. We are again having those discussions with them and will continue to have them and try to find a reasonable compromise. Again, recognizing I have to be mindful of the FHA insurance fund.

Mr. MILLER OF CALIFORNIA. Okay, I agree with that. And I think, Madam Chairwoman, that we worked very well last year in constructing a bill that we all thought would do the best and provide

the most for our basic communities, and I really trust that we can do that again this year, that we can come together and look at good and bad and both and say, "How do we come to some reasonable compromise?" "How do we expand a program that we absolutely understand and acknowledge is beneficial to the market today, that in many cases has been impacted because of lack of participation of FHA and GSEs." And I know for the last 3 years, you and I have looked at this issue, how do we expand it, and I think we are all going in a good direction, it is just how we get there and do we get there in a way that we think is acceptable, and can be applied in a broad base fashion. So I look forward to working with you on this bill as it proceeds.

Chairwoman WATERS. Thank you very much, Mr. Miller. I will recognize Mr. Green of Texas for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman, and thank you very much for hosting this hearing and presenting this piece of legislation. My understanding of the history of the legislation is that the essence of this legislation was captured in previous legislation that was supported by this House and my prayer is that we will receive the same support in this session of Congress.

Mr. Montgomery, thank you very much for being here today. I am so honored to share with my colleagues that you have been very helpful in the current position that you are in, you have been very responsive, and you have gone out of your way to be helpful. You came to Houston, Texas, I believe, to help us with one of our concerns and for this we greatly appreciate you. Just a couple of really quick questions. The first is you give an example in your testimony of a \$225,000 loan and you explain how this will—if FHA were the financier, the borrower would save \$137,000 over the life of the loan. Would you kindly go through this as expeditiously as possible because I do have a second question? I want people to hear from you how you believe you can best serve people with reference to this example.

Mr. MONTGOMERY. I will give you the very quick answer, we price for the risk and the mortgage insurance. Subprime lenders price for the risk and the interest rate. And, thus, you can see the stark, very stark contrast between at a cap of 3 percent, \$39 more a month versus upwards of \$300 more a month, and, yes, \$137,000 over the life of the loan.

Mr. GREEN. And do you consider yourself in terms of positioning, your position somewhere between prime and subprime, is that a fair statement?

Mr. MONTGOMERY. We are far closer to prime for this reason, when a borrower gets an FHA loan through the mortgage insurance, they are essentially buying a prime interest rate.

Mr. GREEN. And the final question has to do with today's news, we find that we have many persons who are being foreclosed on, how would your FHA alternative be a safer alternative than a subprime alternative?

Mr. MONTGOMERY. By far the fact that we are the most transparent loan process out there with the full faith and credit of the U.S. Government backing these loans. There are no surprises with an FHA loan between the no prepayment penalties, which are crippling families today, no teaser rates, no sticker shock. And, as I ref-

erenced earlier, no one has ever said, "I didn't understand my FHA loan", because it is a back to basics approach.

Mr. GREEN. I thank you very much, and I thank you again for coming to Houston. Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you very much. Ms. Capito?

Mrs. CAPITO. Thank you, Madam Chairwoman. Thank you, Mr. Commissioner, for coming. I noticed in your testimony that one of the proposed changes is to increase the loan limits, FHA loan limits, and then you get into some fairly technical kinds of comparisons as to why that is important. Could you just briefly tell me, what are the loan limits and what are you looking to increase them to?

Mr. MONTGOMERY. Right now for the high-cost States, such as California and most of the Northeast, we are at about 87 percent of the conformity rate, which is about \$360,000 a year.

Mrs. CAPITO. That is your max-out rate?

Mr. MONTGOMERY. That is just for those high-cost States. Essentially for everyone else with a few exceptions, give or take, the maximum is around \$200,000 a year.

Mrs. CAPITO. Okay, I know one of the hurdles of home buying, particularly first-time home buyers, is that down payment, and we passed a piece of legislation, the American Dream Down Payment Act, to try to help first-time home buyers jumping over that hurdle. Does your product meld with that? Do your brokers, are they able to couple those together? Do you see that as helping with the potential growth of FHA loans? How do you perceive that?

Mr. MONTGOMERY. Well, the realities have estimated last year about 45 percent of loans were made with no down payment. Our proposal does away with the requirement for a 3 percent cash investment but essentially runs the gamut in between from a 97 percent LTV up to 99.95 LTV, if you will. Because of the risk-based approach and families having some choice, how much they want in an up-front premium or in an annual premium, they can in many cases have that choice. It is just like families have today, some families elect to pay a little higher interest rate to keep more money in their pocket so they can pay for a new refrigerator or upgrades to their home and the like.

Mrs. CAPITO. And how does the FHA from say, the West Virginia Housing Development Fund, is there a good communication between State availability of loans and the FHA? And do you feel like you are working together to maximize the resources?

Mr. MONTGOMERY. We are working together. We can always work together better but again in the high-cost States, the State housing finance agency has difficulty offering an FHA product because of our constraints on the premium structure and certainly on the loan limits.

Mrs. CAPITO. Okay, thank you. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. Mr. Clay for 5 minutes.

Mr. CLAY. Thank you so much, Madam Chairwoman. And thank you for holding this hearing today. Mr. Montgomery, my question is not strictly about FHA. We have a national crisis with home foreclosures and it will affect the national economy in an adverse

way and the effect on some local economies will be devastating. Millions of families will lose equity and their standard of living. I noticed today that even Freddie Mac has decided to purchase \$20 billion in these troubled loans. The executive director of the Equal Housing Opportunity Council report on CBS News that home mortgage foreclosures are up in both the City of St. Louis and St. Louis County, which I represent, when compared to 2005. In 2006, foreclosures were up 44 percent in the City and 34 percent in St. Louis County. What is HUD's position on this crisis? And is HUD designing any special initiatives to combat the rapidly rising foreclosures?

Mr. MONTGOMERY. I think the best way to help many subprime borrowers get out of their loans today is through a modernized FHA, the same song I was singing here last year, and have for the last 20 months. Now relative to the bill that got through this committee last year and through the House, this year though since October of last year we have been doing home buying counseling, working with many nonprofit groups trying to get the word out, working with Realtors to help many families. But while we are helping, as I mentioned before, subprime borrowers today, the best way to do it is to pass this bill to help more.

Mr. CLAY. What is HUD's opinion on the proper amount of government intervention into the market? I think that Freddie Mac has really stepped up to the plate to actually say we will help salvage some of these people's American dream of maintaining their home and holding onto that property. What is the government's proper intervention in a crisis like this?

Mr. MONTGOMERY. With all due respect to my colleagues at Fannie Mae and Freddie Mac, they are private corporations. They have the ability to make decisions overnight. I am not saying I need that ability. But beyond the obvious remedy, modernizing FHA, there are some things we can do in the here and now that we are working on and are on track to help at least 60,000 subprime borrowers this year. Some of these fixes I discussed here in the hearing in this room on Tuesday, and we are putting those through a risk analysis, as the Credit Reform Act requires, and we should know how those will come out in the next month.

Mr. CLAY. So some of those 60,000, you will be able to save their homes, or get them into another form of financing?

Mr. MONTGOMERY. We are on track to help 60,000 this year. It is our conservative estimate, through FHA reform, that we could help easily 200,000 more—200,000 or more in addition to the 60,000.

Mr. CLAY. Thank you. Thank you so much for those answers. And, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much, Mr. Clay. Mr. Ellison for 5 minutes.

Mr. ELLISON. Thank you, Madam Chairwoman. Sir, thank you for coming to visit with us today. I just have a few questions and they are of a more general nature. Could you share with us your assessment of what the unmet housing needs are for Americans today?

Mr. MONTGOMERY. Are you talking about relative to rental housing or homeownership?

Mr. ELLISON. I mean in general.

Mr. MONTGOMERY. Let me take two groups in particular, the elderly and persons with disabilities, an industry group, AUSA, estimates that there are probably 10 seniors waiting for every Section 202 property. That is the elderly housing program HUD has. We have 10 on a waiting list for every one that gets into the property. Some of the disability groups have also talked to us about the urgent need for housing and as part of our early budget we have some demonstration projects that we think will help mitigate that need.

Mr. ELLISON. Thank you. That is similar to the information I received, particularly with seniors, but also just general low-income housing. In Minneapolis, there is a significant waiting list there. Could you speak to what in your view happens to a community when there is such a shortage of housing for certain sectors like seniors, low-income people, or people with disabilities. What do they do? Are they the homeless?

Mr. MONTGOMERY. I cannot speak for the homeless group, that is a little out of my lane, but for many decades, certainly pre-dating my arrival at FHA, there has been a shortage of housing for low-income families throughout America. And we are trying to do what we can in this tight budget environment to help even more through the use of Low-Income Tax Credits, through home funds and others. But certainly I have said publicly, yes, there is a production problem relative to helping some of those groups, and we are trying to fix that.

Mr. ELLISON. I have had a lot of conversations about housing recently and one individual indicated to me that the reason that we are in this housing—in the subprime lending foreclosure situation we are in today is because there has been, over the last 30 years, a liberalization in the rules with regard to making mortgages available to people because we place value on getting people into homeownership. Do you have any views on that?

Mr. MONTGOMERY. Well, I can speak for FHA. Some of what you read and hear, some of the no-income and no-asset stated income products, while inherently that is not a bad product for many families, in the many ways it was used we have some of the problems we are looking at today and that is something FHA does not do. We have rather rigorous and strict requirements relative to things such as income verification, and social security numbers, so that is certainly one of the concerns that we will not do under FHA, at least certainly while I am there.

Mr. ELLISON. I would like to ask you now about housing with regard to people who are ex-offenders coming out, have you had occasion to examine housing for these individuals who have prior contacts with the criminal justice system, perhaps even felony records, is that something you have had any occasion to think about or work on?

Mr. MONTGOMERY. I have not, Congressman, but I would certainly be interested in discussing that with you at a later date.

Mr. ELLISON. In the course of your work, and in your reading, have you recognized or found out whether or not this particular population is having some unique difficulties with regard to obtaining housing?

Mr. MONTGOMERY. Well, there are certainly many groups who have unique difficulties obtaining housing and relative to this group, I would certainly love to hear your views on that at a later time.

Mr. ELLISON. Okay, thank you very much.

Chairwoman WATERS. Thank you very much, Mr. Montgomery. We appreciate the time that you have put in here this morning. I hope that you will pay attention to our housing trust fund and understand that it is very key to getting a bill out of here and some of those other issues, I think, working with Mrs. Biggert, we can resolve. Thank you very much.

Mr. MONTGOMERY. Thank you.

Chairwoman WATERS. I will now call the second panel. Our second panel consists of: Ms. Iona Harrison, GRI, National Association of Realtors; Mr. Lautaro "Lot" Diaz, vice president, community development, National Council of La Raza; Mr. John M. Robbins, CMB, chairman, Mortgage Bankers Association; Mr. Ed Smith, Jr., chairman, CAMB Government Affairs Committee, chief executive officer, Plaza Financial Group, California Association of Mortgage Brokers; and Mr. William P. Killmer, group executive vice president for advocacy, National Association of Home Builders.

While our panel is getting seated, I ask unanimous consent to have the written statements of the AARP and Consumer Mortgage Coalition, as well as letters of support from the National Council of State Housing Agencies and HUD counseling intermediaries entered into the record. Without objection, such will be the order.

Thank you very much. We will start our panel with Ms. Iona Harrison.

**STATEMENT OF IONA C. HARRISON, GRI, NATIONAL  
ASSOCIATION OF REALTORS**

Ms. HARRISON. Good morning.

Chairwoman WATERS. Welcome.

Ms. HARRISON. Chairwoman Waters, and Ranking Member Biggert, thank you for the opportunity to speak before you today. My name is Iona Harrison and I am a broker-owner with Realty Executives/Main Street USA in Upper Marlboro, Maryland. I am here to testify on behalf of 1.3 million members of the National Association of Realtors. We thank you for the opportunity to present our views on the importance of the FHA Mortgage Insurance Program and the urgent need for reform. In fact, when Realtors come to Capitol Hill next month, FHA reform will be one of their primary talking points.

Consumers need a safe, affordable mortgage alternative. In 2006, 1.2 million families entered into foreclosure, 42 percent more than in 2005.

Chairwoman WATERS. Excuse me, Ms. Harrison, will you pull your mike a little bit closer so that we can hear you. It will not move.

Ms. HARRISON. Thanks.

Chairwoman WATERS. Oh, all right.

Ms. HARRISON. I think he was leaning on it.

Chairwoman WATERS. Okay.

Ms. HARRISON. In 2006—is that better—1.2 million families entered into foreclosure, 42 percent more than in 2005. Predatory lending, exotic mortgages, and a dramatic rise in subprime lending, coupled with slowing home price appreciation have all contributed to this crisis. When the Federal Housing Administration was established back in 1934, consumers faced a similar lending crisis. At that time, FHA was an innovator and led the private market in offering safe, affordable home loans to American families. Since its inception, FHA has insured more than 34 million properties. However, the FHA has failed to keep pace with borrower needs and changes in the private market and is no longer a viable alternative for many borrowers. At the same time, the subprime and non-traditional mortgage markets have boomed. Many of these loans offer low teaser rates which reset to much higher rates after a few years. In many cases, these borrowers qualified only on their ability to make the initial payment and face large prepayment penalties if they attempt to refinance. Mortgage experts estimate that approximately \$1.5 trillion worth of adjustable mortgages will reset by the end of 2007. Faced with significantly higher monthly payments, many borrowers will face the possibility of losing their homes.

Realtors support efforts to give consumers affordable alternatives to the more risky loans that are currently being heavily marketed. We believe the FHA could again be a viable, affordable alternative for borrowers with less than ideal credit.

Today, we ask you to advance legislation that would reform the FHA Mortgage Insurance Program in several important ways. Increases in FHA loan limits are needed not just in high-cost areas, but nationwide. Such increases are critical for FHA to assist home buyers in places like California but also areas where home prices exceed the current maximum limit but are not defined as high cost, such as Illinois, Ohio, and Arizona.

Second, we ask you to eliminate the statutory 3 percent minimum down payment on FHA-insured mortgages. In 2005, 43 percent of first-time home buyers financed 100 percent of their home. NAR research indicates that if FHA were allowed to offer this option, 1.6 million families could benefit, including many low-income and minority home buyers. Eliminating the statutory 3 percent minimum cash investment will provide consumers a safe option away from non-traditional products.

Third, NAR supports legislation that would provide FHA with the ability to charge borrowers different premiums based on risks of the borrowers and type of loan product. Currently, all FHA borrowers, regardless of risk, pay virtually the same premiums and receive the same interest rate. Giving FHA the flexibility to charge different borrowers different premiums based on risk will allow FHA to increase their pool of borrowers. Risk-based pricing makes sense in the private market and does for FHA as well.

Fourth, NAR supports moving the Condo Program into the 203(b) Program and combining all single family programs into the Mutual Mortgage Insurance Fund. From a conceptual and accounting standpoint, it makes sound business sense to place all single family programs under the MMIF. We also recommend that HUD lift many of the barriers that make condominium purchase difficult under FHA. We believe the current policies limit sales and home-

ownership opportunities, particularly in market areas where condos are one of the few remaining affordable housing alternatives.

In addition to the reform measures I just outlined, the National Association of Realtors has provided HUD Secretary Jackson with a proposal that would allow FHA to help many families with recent or impending interest rate adjustments refinance into a loan they can afford. Our proposal is to allow credit-worthy borrowers, who may not be current on their existing loan, to refinance into an FHA loan. Many of these homeowners who might otherwise qualify for FHA-insured mortgage are preempted by guidelines that prohibit refinancing the loans that are not current. We believe FHA can design a set of prudent guidelines where credit-worthy borrowers could refinance and avoid losing their homes. NRA has also encouraged HUD to conduct a large public-awareness campaign to fully inform homeowners of their options once FHA reforms are in place. Realtors would support these efforts as a natural extension of our FHA education brochure which we produced with HUD last year.

FHA is the only national mortgage insurance program that provides financing to all markets at all times. Now more than ever, FHA needs to be strengthened so that it will continue to be available to borrowers when they need it most. Realtors stand ready to work with Congress and HUD to breathe new life into the FHA and ensure all Americans can afford to buy and keep their homes for as long as they choose.

Thank you again for the opportunity to testify on this important issue. I stand ready to answer any questions that you may have.

[The prepared statement of Ms. Harrison can be found on page 48 of the appendix.]

Chairwoman WATERS. Thank you very much. Mr. Lautaro "Lot" Diaz?

**STATEMENT OF LAUTARO "LOT" DIAZ, VICE PRESIDENT,  
COMMUNITY DEVELOPMENT, NATIONAL COUNCIL OF LA RAZA**

Mr. DIAZ. Good morning.

Chairwoman WATERS. Good morning.

Mr. DIAZ. My name is Lot Diaz, and I am vice president of Community Development at National Council of La Raza (NCLR). For the past 20 years, I have been working to promote safe and affordable communities for working families. At NCLR, I oversee the NCLR Homeownership Network, a group of 43 counseling agencies working nationwide.

I would like to start by thanking Chairwoman Waters and Ranking Member Biggert for inviting NCLR to participate in the dialogue. I would like to congratulate the members of this committee, and Ms. Waters in particular, for the hard work on FHA reform.

The Expanding American Homeownership Act of 2007 improves on the previous versions of the bill. In the past 8 years, I have seen FHA go from a product of choice in our communities to one used by far fewer families. Since FHA has an important role to play, now is the time for a modernized FHA program.

In my time here today, I would like to discuss three main points: Why a stronger FHA is good for Latinos; the importance of greater

access to homeownership counseling; and other ways FHA can promote Latino wealth building.

Let me start with why we need a stronger FHA. FHA has been a traditional way for Latino families to achieve homeownership, however aggressive subprime marketing in our communities have pushed FHA to the sidelines. The number of Latinos using FHA have been decreasing every year. At the same time, many of our families do not have good loan options to choose from. As a result, they are vulnerable to predatory lenders. A competitive FHA would be a safe alternative for Latinos with fewer loan options.

In addition to affordable loans, Latino families benefit from homeownership counseling. NCLR created a network of housing counselors 10 years ago. Now we are serving more than 33 Latino communities across the country. Last year, we helped nearly 3,000 families purchase their first home. Participants cite counseling as one of the most important factors in their ability to successfully purchase. Research also shows that these families are far less likely to default. H.R. 1852 increases the availability of counseling for FHA borrowers. This is especially important for borrowers who would access the newer products such as zero down payment and interest-only loans.

Last year, we also helped over 1,000 families who were already homeowners. Some were falling behind on their loan payments; others needed help to be refinanced in a more affordable mortgage. For many families in danger of default, time is the enemy. The earlier we can talk with the borrowers regarding their late payments, the better. Counselors are working hard to get the word out for their services but this is not enough. Counselors need more resources and they need to get to the borrower before it is too late. Congresswoman Waters and Congresswoman Velazquez worked on this issue. The opt-in provision of H.R. 1852 will allow families access to foreclosure prevention assistance. FHA borrowers will be able to sign a form saying they want a counseling agency to contact them in the case of default. We believe this is a powerful tool that will connect families with intervention services when they need it.

One successful example of foreclosure assistance is Ms. Vega. She came to visit the Spanish Coalition for Housing in Chicago a couple of months ago. Her mortgage payments jumped unexpectedly and she could not make them. The initial repayment plan offered by her servicer was too expensive. Our counselors were able to negotiate on her behalf and because of their work, the terms of Ms. Vega's loan have been modified. If it weren't for the Coalition's work, she would have lost their family's home.

There are other noteworthy additions to this FHA modernization bill as well. The bill includes rewards for families to pay on time. Clearly, on-time payers have proven that they are a lower risk. Legislation would reduce the insurance premium over time. We also support raising the FHA loan limits in high-cost areas. Clients in our groups in California; Seattle, Washington; Boston, Massachusetts; and Alexandria, Virginia, for instance, face high housing prices. FHA would be available to more families if the loan limits were higher. Finally, the cap placed on fees will keep FHA affordable to all of our borrowers, which is really important.

Let me close by offering a couple of suggestions to further strengthen the bill: increase funds for housing counseling to \$100,000 million and make sure counseling agencies can earn fees for the services they provide to industry; reinstate the FHA discount for families that got counseling through HUD-certified programs; and finally FHA should set the bar for industry ethical standards. We need a code of ethics to hold originators accountable given the potential changes to the FHA program.

Thank you. I would be happy to answer any questions at your convenience.

[The prepared statement of Mr. Diaz can be found on page 43 of the appendix.]

Chairwoman WATERS. Thank you very much.  
Mr. Robbins?

**STATEMENT OF JOHN M. ROBBINS, CMB, CHAIRMAN,  
MORTGAGE BANKERS ASSOCIATION**

Mr. ROBBINS. Good morning, Chairwoman Waters, and Ranking Member Biggert. Thank you for holding this hearing and inviting me to share MBA's views on reforming the FHA. I have spent over 36 years working with FHA and have made billions of dollars in loan originations to families who have achieved the dream of homeownership through FHA's programs. When I started in the mortgage business, FHA programs helped us to serve many borrowers who otherwise could not get a loan. Today, the story is very different. In 2003, FHA made up approximately 16 percent of our overall production. Last year, however, only a little more than 1 percent of our business went to FHA. While the mortgage market has grown significantly, our use of the FHA program has dropped precipitously. Lenders have progressed, reacting to quickly changing and efficient technology. Unfortunately, FHA has not. While the needs of low- and moderate-income home buyers, of first-time home buyers, and of senior homeowners have changed, FHA has not followed its historic path of adopting to meet borrowers' changing needs.

MBA strongly supports FHA and believes that it still plays a critical role in today's marketplace. Most of FHA's business is directed toward low- and moderate-income and minority borrowers, the very strata that is most challenged to be part of the American Dream. At the same time, we have watched with growing concern as FHA has steadily lost market share over the past decade, potentially threatening its long-term ability to help underserved borrowers. As the market continues to evolve around FHA, the great fear is that many aspiring homeowners will either be left behind or forced into higher cost alternatives.

MBA notes with great concern that the Administration's fiscal year 2008 budget proposal estimates that the FHA Mortgage Insurance Fund will go into the red next year unless changes to the existing program are made or additional appropriations are provided. MBA agrees with the Administration that the FHA's Mutual Mortgage Insurance Fund would run in the black with little or no premium increases necessary if FHA reform proposals were passed this year.

MBA applauds the introduction of FHA reform bills, H.R. 1852 and H.R. 1752, and that they started the reform effort early in the 110th Congress. MBA strongly supports changes to FHA's single family and multi-family loan limits and down payment flexibility and requirements including the elimination of the complicated down payment formula. The down payment is one of the primary obstacles for first-time minority and low-income borrowers. We believe Congress should empower FHA to allow it to meet today's needs and anticipate tomorrow's. The MBA believes changes should also be made in three areas: FHA needs more flexibility to introduce innovative new products; invest in new technology; and manage their human resources. Finally, MBA also supports changes to the Home Equity Conversion Mortgage Program. MBA's surveys show that FHA's HOEPA product comprises 95 percent of all reverse mortgage and is thus tremendously important for senior homeowners.

In conclusion, FHA has an important role to play in the market in expanding affordable homeownership opportunity for the underserved and addressing the homeownership gap. For low- and moderate-income families, FHA should be the financing considered first because it has the lowest rate and provides the borrower the best opportunity to become a successful homeowner. However, the current loss of market presence means we are losing FHA's impact. The result is that some families are either turning to more expensive financing or just giving up. I urge Congress to enact legislation to reform FHA to increase its availability to home buyers, promote consumer choice, and ensure its ability to continue serving American families. MBA stands ready to work with you on this important issue. Thank you.

[The prepared statement of Mr. Robbins can be found on page 71 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Smith?

**STATEMENT OF ED SMITH, JR., CHAIRMAN, CAMB GOVERNMENT AFFAIRS COMMITTEE, CHIEF EXECUTIVE OFFICER, PLAZA FINANCIAL GROUP, CALIFORNIA ASSOCIATION OF MORTGAGE BROKERS**

Mr. SMITH. Good morning. Thank you very much for having me here, Congresswoman Waters, and Mrs. Biggert. On behalf of the California Association of Mortgage Brokers, of which I am the vice president of government affairs and industry relations, I want to bring a different perspective to the table, I am actually a practicing mortgage broker who deals with customers on a daily basis. For the past 24 years in my marketplace, I have seen many, many families come to my office, sit down with me, and we have structured an opportunity for them to have the American Dream. Part of that conversation normally when we get started is the expectations of homeownership, their dreams of homeownership. We talk about the future of building generational wealth. Those conversations occur in every time and in every opportunity that I have to serve someone with doing a mortgage for them.

Over the past few years, I have seen the FHA loan product in our marketplace in California completely disappear. The colleagues

who are here obviously have articulated that fact over and over again. My perspective that I want to bring to you is the ground level eyeball conversations that we have. When someone walks into our office and looks into buying a home—a median priced home in southern California is over \$500,000—this has a devastating effect on them. We are now, because of the loan limits in California being low, California not being designated as a high-cost State, we have very limited opportunities and products available to deliver a sustainable loan. Over the past few years, we have gone to the subprime market. The subprime market has now been the conventional solution to the lack of sustainable loan products through FHA. I used to do FHA loans all the time. We do not do those anymore because it is not applicable in our marketplace, the loan limits are too low. So, consequently, we have gone to 100 percent financing with subprime loans. We have gone to interest-only products which keep people in a low payment opportunity to be able to maintain those homes, but we try to develop a sustainable plan for them to keep their homes, to refinance into their homes. Many of those plans and dreams have not occurred. After 2 years or 3 years, those interest-only products have reset, payment shock has set in, and their financial dynamics have completely changed, which puts them in a position of financial peril.

We all know where we are with foreclosures. We are dealing with foreclosure rates that are escalating throughout the country, especially in your district and in my marketplace in San Diego. What alternatives do we have now other than to go out to the marketplace and try to find another sustainable product for them that is not available? The liquidity, the availability of loans and products has diminished dramatically. Those customers sit there and look me in the eye and ask me, “Smitty, what am I going to do? How can I keep my home for my family?” I have to research, dig and try to find products to keep people in their homes that are not there anymore. FHA is a very viable solution to the subprime crisis that we are in right now. It delivers a sustainable product that has no prepayment penalties, fixed rate loans, and impounds for taxes and insurance. These are the type of financial instruments that, if we have available to us, we will be able to put people in their homes, keep them in their homes, and preserve the homeownership opportunities that they have started with.

One of the things that is a big drawback throughout America, and specifically in California, is that the mortgage broker, the small business, does not have the availability of the FHA product. We are the number one delivery channel for home loans in America. We produce approximately 70 percent of every home loan in America. If we do not have the opportunity to deliver that sustainable product to low- and moderate-income individuals, we are cutting 70 percent of the opportunities out for people who want to keep their homes.

What I would encourage us to do is to have a solution that keeps us, the mortgage broker, the person who is in the community, who lives in the communities, who works in the communities, we go to church with our customers, we build our businesses on referrals. It is incumbent upon us to work hard for each and every customer we have because we live and work with them. We operate on repeat

business. If giving us the opportunity—if giving mortgage brokers the opportunity to deliver the FHA product, I believe that would be the first step in the solution to the foreclosure ratios that we are having now and to build a long-term base for sustainable—for maintaining sustainable homes and build net worth for customers in the future.

[The prepared statement of Mr. Smith can be found on page 88 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Killmer?

**STATEMENT OF WILLIAM P. KILLMER, GROUP EXECUTIVE VICE PRESIDENT FOR ADVOCACY, NATIONAL ASSOCIATION OF HOME BUILDERS**

Mr. KILLMER. Thank you, Chairwoman Waters, Ranking Member Biggert, and members of the subcommittee. My name is Bill Killmer and I am the National Association of Home Builders Group vice president for advocacy. We thank you for the opportunity to testify on behalf of NAHB on the subject of FHA revitalization. First, I want to thank the members of this subcommittee for your strong bipartisan support of FHA reform during the 109th Congress and for taking action so quickly here in the 110th.

The ongoing turmoil in the subprime mortgage markets greatly increases the urgency for enactment of FHA legislation. While subprime mortgage programs have played a valuable role in expanding homeownership opportunities, some lenders have resorted to less rigorous lending practices that have harmed borrowers in the housing finance system. The unfortunate experience of such borrowers provides the compelling reason why FHA needs the tools to meet its mission objectives more effectively. Indeed, I believe that much of the trouble in the subprime mortgage market and the hardships it has produced for many borrowers could have been avoided if the FHA had been in a better position to respond to changing market forces in the past few years. The popularity and relevance of FHA single family mortgage insurance programs waned over the past 2 decades as its programs failed to keep pace with mortgage market developments and needs. That vacuum was exploited during the past 5 to 7 years as competing subprime mortgage loan programs lured many borrowers into untenable situations.

FHA's lack of responsiveness to market needs has placed many borrowers in highly risky and inappropriate loan structures where they were charged unreasonably high fees and interest rates and often faced onerous pre-payment terms. Many of these borrowers, despite limited cash resources and/or tarnished credit, could have qualified for market rate FHA-insured loans. In numerous instances, this is due to statutory constraints that have limited FHA's ability to respond to the needs of borrowers who might have otherwise chosen FHA.

So NAHB looks forward to working with the committee in the coming weeks to advance comprehensive FHA reform legislation that includes, among many other worthy changes, the following key reforms.

First, the current limit for FHA-insured mortgages is too low to enable deserving potential home buyers to buy homes in many high-cost areas. The artificially low limit restricts choices for home buyers who use FHA-insured mortgage loans. They are pushed to the lowest echelon of available homes throughout the country and in many areas FHA loan limits preclude borrowers from purchasing new or recently constructed homes. So NAHB supports recalibrating local loan limits to 100 percent of the area median and increasing the national floor for FHA loan limits.

Second, NAHB believes that FHA can effectively serve a broad range of borrowers while acknowledging that the risk of default varies widely. In fact, some delineation in credit risk is necessary if FHA is going to prudently provide an alternative to subprime borrowers who cannot get reasonable loan terms on conventional loans. To be competitive, FHA must also have greater flexibility in establishing down payment requirements and both comprehensive reform bills currently before the subcommittee contain provisions that would alter the present structure for determining the amount of cash a borrower would have to invest to qualify for an FHA-insured loan in addition to the parameters to which the mortgage inserts premium would be determined. NAHB has long supported efforts to provide the FHA flexibility in these areas, and we look forward to working with this committee to advance such needed reforms.

Third, in many communities condominiums represent the most affordable path to homeownership. Unfortunately, FHA's requirements for condo loans are burdensome, differing significantly from requirements for mortgage loans that are secured for single family detached homes. The net result is a severe limitation on the availability of FHA-insured mortgages for those attempting to purchase a condo unit. So NAHB supports efforts to consolidate all of the single family mortgage insurance programs under one section of the National Housing Act. This would be a major step in reopening FHA-insured financing to this critical affordable market segment.

Fourth, FHA's Home Equity Conversion Mortgages, or HECMs, allow homeowners who are at least 62 years old to access equity in their homes without having to make mortgage payments until they move out of their home. HECMs have found increasing acceptance among seniors as a financial alternative. However, the current program cap and the unrealistically low loan limit keep FHA from serving this growing segment of the population. Reform legislation should also ensure that seniors are able to employ HECMs to purchase homes that are more suitable to their current lifestyle and activities, including newly built homes that typically offer lower maintenance and operating costs.

And, finally, NAHB supports efforts to increase limits on FHA-insured multi-family loans in high-cost areas. Currently, there are some areas in the country where construction costs are so high that use of the FHA programs is just not possible. With severe shortages of affordable rental housing in most of the high-cost markets, this change would enable developers to provide much needed new affordable housing to low- and moderate-income families.

Thank you once again for this opportunity, and I would welcome any questions you may have.

[The prepared statement of Mr. Killmer can be found on page 56 of the appendix.]

Chairwoman WATERS. Thank you very much. We are going to move right into our questions now, and I will recognize myself for 5 minutes. For the first set of questions, I want to go directly to you, Ms. Harrison. You said you submitted a set of recommendations to HUD. Do we have a copy of those recommendations by any chance? If not, would you please submit them.

Ms. HARRISON. It has been sent to staff and we can make sure that you and the other members of the committee receive those directly.

Chairwoman WATERS. I would appreciate it because it sounds as if you have some very, very good recommendations. I have heard twice now about the condo problem.

Ms. HARRISON. Yes.

Chairwoman WATERS. Mr. Killmer has referenced it and you referenced it first, so would you explain to me what is the problem with the financing of condos by FHA?

Ms. HARRISON. Certainly, ma'am, thank you. There are several provisions, at this moment condos are financed, there are four different funds that FHA uses. Single family is the MMIF fund. What we propose is that condos be moved to the single family, the MMIF, because it is an appropriate place for it to be and it does not have the problems with—occasionally funds stop for these programs under the other fund. The continuity of funds is important for us as Realtors and for home buyers because if you have written a contract to purchase a home, one assumes that the funds will be there when you are ready to close. And if the availability stops due to some other constraint in a multi-family area or some other problem, it is extremely frustrating, and we are talking about probably a major life event for that first time home buyer who is purchasing the condo. There are other—the smaller strictures, for instance, if you are buying a condominium in a development, you have to prove that 51 percent of those are homeowner occupied. I myself can remember—and this has not changed throughout time, so you can see that the paperwork involved in even trying to “prove” who lives in a house at some time can be very difficult and that prevents a borrower from perhaps purchasing a home, and this was in the Fort Washington area of Maryland, that would have been a very feasible option in every other way but the funding was not available.

Chairwoman WATERS. I get it. We are going to take a look at that.

Ms. HARRISON. You are a quick study.

Chairwoman WATERS. The other thing that I am going to ask you and others maybe to refer to in the few minutes that I have left is, is this refinancing of existing mortgages by FHA a problem, or is it not allowed?

Ms. HARRISON. Currently, my understanding is that if the homeowner is considered to be in default, that does not even have to be in foreclosure, they are behind on their payments, they are not allowed to refinance, and we think that if they are credit worthy in every other respect that the opportunity to refinance into an FHA

product would prevent a defaulting borrower from becoming a foreclosure borrower.

Chairwoman WATERS. Okay, so you would suggest to me that we could help to straighten out the situation for those who are about to be in trouble, or may have gotten into trouble already, so that they could refinance and FHA would be able to save them from losing their homes right now with this crisis that we have going on, is that correct?

Ms. HARRISON. That is our proposal and, yes, we believe that is indeed possible, but of course it would call for expeditious passage of legislation to allow that.

Chairwoman WATERS. Okay.

Mr. ROBBINS. Very briefly, let me add?

Chairwoman WATERS. Yes?

Mr. ROBBINS. Madam Chairwoman, one of the problems is that it is very difficult to get to borrowers when they go into delinquency. Like human nature dictates, sometimes when you owe people money, they are the last ones you want to talk to. And so they do not respond to queries and many times we have to use consumer groups and whatever means we have to get to them. Under current FHA regulation, at the time they go into delinquency, FHA could not come in and be one of the solutions or represent one of the solutions. So Commissioner Montgomery's ability to change that language, I think, would be imperative to helping many, many homeowners who are trapped in those mortgages today.

Chairwoman WATERS. All right, we will certainly make note of that. I am going to go to our ranking member, Mrs. Biggert, now for questions for 5 minutes.

Mrs. BIGGERT. Thank you, Madam Chairwoman. Mr. Killmer, how do we ensure that there are adequate underwriting standards for FHA products so that the expansion into a pool of risky borrowers will not pose a threat to the Mutual Mortgage Insurance Fund?

Mr. KILLMER. I think that is a careful balance that the subcommittee has to strive for—clearly diving deeper into that pool is going to help the broad strata of folks that FHA could reach. NAHB believes that the provisions that are in both of the bills go in the right direction in terms of risk-based credit pricing and the changes in the down payment requirements and certainly the mortgage insurance premium provisions. And we would urge that those provisions be as simple and straightforward given the nature of the complexity for the borrower to understand so that they will be utilized to a more full extent.

Mrs. BIGGERT. Thank you. Would anyone else like to respond to that?

Mr. ROBBINS. Yes, just a very brief comment for you.

Mrs. BIGGERT. Mr. Robbins?

Mr. ROBBINS. Part of the foreclosure issue that we are going to be facing and looking at currently was caused by low FICO scores, no income, and no asset underwriting. FHA, I would like to remind all of the Congress, that FHA uses specific underwriting, more traditional underwriting, in the approval of their loans. And so it is relatively rigorous and should not be confused with what caused some of the problems that we are currently facing.

Mrs. BIGGERT. Thank you. Ms. Harrison, in one of my former lives, I did real estate as an attorney. In Illinois, there was a court case which after that required attorneys to be present at closings. And one of our jobs obviously was to go over the loan agreement and explain that to the purchaser. How close are the Realtors to examining the loan documents since Realtors are the ones that really are on the forefront of encouraging a buyer to be able to come up with the monies for a home, and I was just wondering if Realtors ever really see, well, this person really is never going to make it but we are going to go ahead with the sale?

Ms. HARRISON. That is an excellent question and we as Realtors, indeed Realtors and not attorneys, and certainly we would never set ourselves out to be attorneys, traditionally accompany our buyer clients and our seller to the settlement table and sit there and will assist them with our own advice but the need for counsel and to review documents is still something that we would encourage our buyers to do, to have their own counsel. In the State of Maryland, you often make settlements in an attorney's office, but very often it may simply just be a settlement officer not actually an attorney who explains the documents. And, quite frankly, if you have seen—if any of you have seen loan documents recently, they are extraordinary in their complexity. I remember the former secretary, Mel Martinez, said that he as an attorney was absolutely floored by the volume of documents that they look at. We give people the opportunity to examine their Truth in Lending statement at the time that they are making loan closing and again will offer what expertise we have. But once again we are facilitators of the transaction and certainly would never set ourselves up to give them that type of advice.

Mrs. BIGGERT. Thank you. I will yield back so we can continue.

Chairwoman WATERS. Thank you very much. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. Since we have a vote coming, I will be brief. In H.R. 1852, which was introduced by Chairwoman Waters and Financial Services Chairman Barney Frank, it includes a requirement for pre-purchase counseling for zero or lower down payment borrowers, the higher risk borrowers. I am interested in getting a response from each of you. Do you feel that is cumbersome, that it burdens those who are in the business of trying to get these mortgages done?

Mr. SMITH. I would like to take that answer.

Mr. CLEAVER. Thank you.

Mr. SMITH. On behalf of our organization, financial literacy skills and financial literacy subsets are the cornerstone of our process. We strongly advocate financial literacy skills for individuals at an earlier age, even before they start buying a home, but especially when it comes to buying the largest investment of their life. Currently, under some government subsidized programs, down payment assistance programs, in order to qualify for those programs, you have to participate in pre-purchase counseling. From our Association's standpoint, we strongly agree with that and it helps not only in that particular transaction but those skill sets can be extrapolated into future financial decisions. We strongly agree with that and it is not a cumbersome process.

Mr. CLEAVER. Thank you. Ms. Harrison?

Ms. HARRISON. Yes, we, the National Association of Realtors, support borrowers having the option of getting information about the availability of counseling services and recognize the importance for many families to get that extra instruction to make financial decisions about this very important purchase.

Mr. ROBBINS. I would also add that we support counseling strongly, but not mandatory counseling, because it increases costs to the borrower and slows down the process.

Mr. CLEAVER. I am sorry, the last part?

Mr. ROBBINS. Because it increases the cost to the borrower and slows the process down. So we support counseling absolutely but not mandatorily required. My understanding is that it is not mandatory in the bill, it gives the commissioners guidelines to determine the extent of counseling that should be available. But it is our experience that counseling has been really effective to avoid poor decision-making because of lack of information. And so we have been working very hard to expand those services broadly and any time it could be inserted into the process, we found it helpful to low- and moderate-income buyers.

Mr. DIAZ. Yes, I would say that we join with the others and are in strong favor of the provisions that are in the bill, would not find them cumbersome, but only say that if this moves forward as part of the reform legislation, that the Congress work to appropriate enough HUD funds so that the counseling services would be available.

Mr. CLEAVER. I think in the HUD budget, there is like \$50 million?

Mrs. BIGGERT. Would the gentleman yield just for a quick insert here?

Mr. CLEAVER. Yes.

Mrs. BIGGERT. We have a problem in Illinois where in one county, it started out just in a small section but there is a requirement for counseling and it is for everyone no matter what size mortgage it is, and there just are not the people there to do the counseling, people cannot close, and they are losing houses because their mortgage does not go through. So we need to look closely at that.

Chairwoman WATERS. Let me just, if I may, Mr. Cleaver, ask you to yield, so that Mr. Ellison may ask a question, and then we are going to adjourn the committee. We have votes, and have about 8 minutes left on the Floor. May I?

Mr. CLEAVER. I yield to the ranking member of the committee.

Mr. ELLISON. Madam Chairwoman?

Chairwoman WATERS. Yes.

Mr. ELLISON. The questions I have maybe I can catch one of our panelists in the hallway. Okay, well, let me just ask you this question, and particularly Mr. Smith, your experience as mortgage originator, after you do the deal, the mortgage originator takes their fees out and then moves it on and a loan officer will—after the loan goes to the secondary market, what happens to loans that end up in foreclosure once they enter the secondary market and are securitized, could you speak to that reality and how that impacts on the generalized effect of the foreclosure phenomena we see happening nowadays.

Mr. SMITH. That is a good question. Once a transaction is closed with a mortgage broker and it is actually moved on to the secondary market, that loan is then taken over by a loan servicer. That loan servicer is the one who is in communication with the customer on a monthly basis collecting payments and paying taxes if it is impounded. Once that transaction goes beyond—gets into default, that customer is notified and called and continuously attempted to be contacted to work out some type of plan or to determine what in fact the problem is to get that person back on track. Yes, sir?

Mr. ELLISON. If I could just follow up real quick. So one of the things that I have been concerned about is who is left to do a workout with the customer once the mortgage has been sold to the secondary market, the bank no longer has it, who in your view is in a position to re-work the terms of that mortgage so that it doesn't end up in foreclosure?

Mr. SMITH. The loan servicer would be the first avenue of redress for the consumer who has experienced a payment default. And there are programs, I need to be real clear with you, the loan servicer on the secondary market is extremely, extremely motivated in working with the customer to keep that loan on the books and get it back into a paid-as-agreed status.

Mr. ELLISON. Thanks.

Chairwoman WATERS. I would like to thank all of the members of the committee for being here today to help us learn more about this FHA reform that we have embarked upon, and I would like to also thank the panelists for taking time from their busy schedules to travel to be here with us today. Your information is invaluable. We will get an FHA reform bill through this Congress. We certainly have a few differences to work out, but I am convinced that just as we were able to move the bill before, we will be able to move it again, and it will be a bill that I think most people can embrace. So thank you so very much for being here today, and I look forward to working with you.

Mr. SMITH. Thank you very much.

[Whereupon, at 12:00 p.m., the hearing was adjourned.]

# **A P P E N D I X**

April 19, 2007

**Statement of Representative Gary G. Miller  
Subcommittee on Housing and Community Opportunity  
Hearing on "FHA Modernization"**

**April 19, 2007**

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This morning the Subcommittee on Housing and Community Opportunity meets to consider reforming the Federal Housing Administration's (FHA) single-family mortgage insurance activities.

Commissioner Montgomery, I welcome you today and would like to commend you for your work to ensure the FHA program once again becomes a viable option for low and moderate income homebuyers.

Your leadership and vision has already resulted in many regulatory improvements to the program, and I look forward to working with you to make the statutory changes necessary to restore the relevance of FHA in today's marketplace.

I wholeheartedly agree with you that we must reform FHA, so its programs can reach the working families it was created to serve.

When I talk to brokers and lenders in my district, it is clear that the FHA program, as currently structured, has not kept pace.

In the past, first-time, moderate-income homebuyers who could not qualify for conventional loans because of high loan-to-value ratios or high payment-to-income ratios could still achieve the dream of homeownership through the FHA program.

Today, FHA is no longer a useful product for prospective homebuyers. Instead, working families are faced with a situation where they are either unable to own homes or they are forced to resort to risky loan products that might make their ability to keep their home difficult.

While FHA was created more than 70 years ago to meet the needs of those underserved by the private sector, today it is not living up to this mission and working families are left without an affordable alternative to financing a home.

The problem is that statutory limitations preclude the FHA from adapting to a rapidly changing marketplace.

As the private sector mortgage market has become more efficient, the FHA program's inflexible rules and requirements have left it virtually irrelevant as a financing option.

**High Cost Areas**

This is especially true in high cost areas of the country, where statutory loan limits eliminate the program as an option for the purchase of an entry-level home.

Under the current limits, FHA products are not available for homebuyers in high cost areas of the country because the maximum mortgage limit is lower than housing prices.

Working families who need and qualify for FHA are effectively kept out of the program because of where they live and work.

California's drop in FHA volume has been nothing short of stunning.

In 2000, FHA insured 109,074 mortgages in California. But last year, FHA insured only 5,137 loans.

In my district alone, FHA insured over 7,000 mortgages in 2000 and only 80 in 2005.

These figures represent a decrease of 99 percent in just five years – by far the largest in the country.

Arguably, working families in high cost areas of the country are just the kind of underserved population the FHA program was intended to serve.

If we want to ensure FHA is relevant for all those who need it, we must reform the program so that it is available to low and moderate income families across the country, even those in high cost areas.

#### **How to Make FHA a Relevant Option for Homebuyers**

The bottom line is, to make the FHA program a viable mortgage option, we must ensure that the program allows for the purchase of entry level homes.

This includes not only eliminating the geographic barriers to utilization of the program in high cost areas, but also facilitating the purchase of entry level homes, including condos and manufactured housing.

These forms of housing are an affordable option for entry-level homeownership and they should be included under this program if we truly want to make it help families climb the 'first rung on the ladder of homeownership.'

In addition to reforming *what* can be purchased under the program, we must also consider the competitiveness of FHA products, as currently structured, among the mortgage options available.

In other words, we must explore the reasons that the program is not being utilized when it is an available mortgage product for a potential homebuyer.

The answer is that the program's inflexibility and burdensome processes have left many in the industry hesitant, or actually unable, to offer FHA products to clients.

**Conclusion**

By reforming the FHA program, and making it relevant in today's marketplace, we have the opportunity to ensure that the dream of homeownership can be achieved by more Americans in a way that is most affordable and less risky.

Commissioner Montgomery, I look forward to hearing from you about how we can remove the impediments to the utilization of FHA so that it can once again help working families across the country have the opportunity to achieve and maintain homeownership.

**Opening Statement for Housing and Community Opportunity**  
FHA Reform Hearing  
April 19, 2007  
**Congressman Albio Sires**

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Thank you Madame Chairwoman for having this hearing today. I look forward to hearing from these distinguished witnesses about H.R. 1752 and H.R. 1852.

I realize some argue that the private sector can best serve the mortgage needs of American families. Yet the recent news about the rates of foreclosures in the subprime market indicates that this may not always be the case. Earlier in my career I ran a title insurance company. I understand that the private market plays a vital role in housing for Americans. I also understand the business perspective of limiting regulation. But I think that we must recognize that the private market is not doing a good enough job right now in the subprime market.

**Opening Statement for Housing and Community Opportunity**  
FHA Reform Hearing  
April 19, 2007  
**Congressman Albio Sires**

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Having said that, I am proud that this Committee has taken the lead in this area. The bills we are discussing today will make improvements to the F-H-A and will make safe and sound homeownership a reality for more Americans.

Thank you Madame Chairwoman.



**Leveraging the Federal Housing Administration (FHA) Loans to Build Wealth in Latino Communities**

Presented at:

**The "Expanding American Homeownership Act of 2007": H.R. 1852 and Related FHA Modernization Issues**

Submitted to:

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

Submitted by:

**Lautaro "Lot" Díaz, Vice President, Community Development (CD)  
National Council of La Raza**

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April 19, 2007



My name is Lot Diaz, I am Vice President of Community Development for the National Council of La Raza (NCLR). For more than 20 years I have been working in the community development field on behalf of low-income families. At NCLR, one of my main responsibilities is to oversee the NCLR Homeownership Network (NHN). NCLR is the largest national Hispanic civil rights and advocacy organization in the U.S. dedicated to improving opportunities for Hispanic Americans. I would like to thank Chairwoman Waters and Ranking Member Biggert for inviting NCLR to share our views on the expansion of Federal Housing Administration (FHA) home loan opportunities. NCLR fully supports a revitalized FHA program. In 2005, 10% of Latino families relied on FHA loans to purchase their first home.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services for low-income people, and promoting homeownership in the Latino community. In addition to its policy and research work, NCLR has been helping Latino families become homeowners for nearly ten years as a sponsor of housing counseling agencies. The NCLR Homeownership Network (NHN), a network of 42 community-based counseling providers, works with 20,000 families annually, nearly 3,000 of whom become homeowners. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided \$400 million in financing for locally-based development projects throughout the country, building the capacity of local nonprofits and creating opportunities for Latino communities. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market.

We commend Congresswoman Waters and Chairman Frank for their work on H.R. 1852, the "Expanding American Homeownership Act of 2007." The bill includes several improvements over H.R. 5121, the version of the bill that was passed by the House in 2006. While the bill passed with overwhelming bipartisan support, we believe several of the added provisions will help put Latinos and other underserved borrowers on a path to sustainable homeownership and wealth-building. Generally considered the ticket to the middle class, affordable loan options that promote homeownership often do not meet the needs of many low- and moderate-income Latino homebuyers. The number of Latinos with FHA loans has been decreasing while the number of Latinos with subprime loans has been increasing. Recently, the subprime market has been dominated by high costs and risky mortgage products.

In my testimony today, I will discuss the importance of a strong and competitive FHA program to Latino homebuyers, highlight the increased counseling opportunities included in the bill, and underscore other provisions in the legislation of significance to Latino families.

#### **Federal Housing Administration**

For more than 70 years, FHA has served low- and moderate-income families, often representing their only affordable loan option. During that time, FHA has often changed the face of the affordable lending market through its product innovations, such as the 30-year amortizing mortgage and low-downpayment requirements. While the private market has evolved to offer

more affordable products, FHA is unique in its social mission to provide homeownership opportunities to underserved communities. However, it has not been without its challenges. In the mid-1990s, FHA loans were often cited as the vehicle for flipping scams. It has also had higher foreclosure rates than conventional lenders.

Recently, FHA has experienced a dramatic reduction in its market share. In 2001, for example, one in four Latinos with a mortgage had an FHA loan. In 2005, that number dropped to just more than one in seven. In the meantime, the share of Latinos accessing subprime mortgages has grown dramatically. In 2005, 40% of Latinos had subprime mortgages. In many cases, Latino families have been steered unnecessarily toward these more expensive, and often riskier, loan products. Now we are seeing studies that project a foreclosure rate as high as 12% for Latinos.

Despite FHA's troubled past, a revitalized FHA program could once again spur market innovation. For many Latino homebuyers, having access to safe and affordable home loans can mean the difference between building wealth and facing unmanageable debt and foreclosure. Many Latino families looking to purchase their first home face unique barriers. For example, 22% of Latinos do not have enough payment information on file to generate a credit score and more than one-third do not have traditional banking or savings accounts. Multiple wage-earners and sources of income in one household are also common characteristics of first-time Latino homebuyers. In an automated world, many loan originators do not take the extra-time required to connect these families to flexible mortgage products that accommodate these qualities. As a result, many Latino families are unfairly steered toward products that are expensive and sometimes risky. A stronger, more flexible FHA program that is widely available would serve as an affordable alternative to costly loans.

**“Expanding American Homeownership Act of 2007” (H.R. 1852)**

“Expanding American Homeownership Act of 2007” would make a number of changes to the FHA program, introducing a new risk-based pricing system, creating new counseling and loss mitigation opportunities, rewarding on-time payments, lowering downpayment requirements, and increasing access through higher loan limits. NCLR supports a strengthened and more competitive FHA, but such expansion must be approached with caution.

The new opportunities to access homeownership counseling included in H.R. 1852 are important for Latinos in this respect. Research has shown that access to homeownership counseling reduces the chances of default. In a study evaluating NHN,<sup>1</sup> families who received services from NHN organizations cited one-on-one counseling as one of the most important determining factors in their ability to purchase their first home.<sup>2</sup> After ten years in the business, NHN organizations have helped more than 25,000 families purchase their first home. Pre-purchase homeownership counseling can help ensure that as FHA incorporates zero downpayment and other potentially risky products – such as some adjustable rate mortgages (ARMs) and those that

<sup>1</sup> The NCLR Homeownership Network was created in 1997 to provide homeownership counseling services to low-income Latino communities in an effort to increase Latino homeownership.

<sup>2</sup> Johnson, Ryan and Elsa Macias, *Home-to-Own: A New Model for Community-Based Low-Income Mortgage Lending*. Tempe, Arizona: Morrison Institute for Public Policy, 1995.

include interest-only options – that borrowers receive these products when they are ready and fully aware of their alternatives.

FHA must also be prepared to assist borrowers who experience financial hardship and default on their mortgage payments. Families in this situation can benefit from timely loss mitigation services. Although FHA currently offers a strong loss mitigation program, the services are little use to a family that does not receive them. Often families in financial crisis are too embarrassed or too distracted by their life events that they avoid their servicer and never learn about the repayment tools available to them. In other cases, servicers do not take the time necessary to determine the needs of the family and provide them with foreclosure prevention services. The “opt-in” provision included in H.R. 1852 begins to address this by helping counseling agencies and servicing companies overcome the privacy laws that prohibit information sharing. In many cases, an independent, community-based counseling agency is in a better position to outreach to borrowers in default. The opt-in provision is a waiver presented to FHA borrowers at closing that gives the servicer permission to share their information with a Department of Housing and Urban Development (HUD)-certified counseling agency in the event they become delinquent. When borrowers are reached early in the delinquency stage, they still have many options available to them to overcome their situation.

Inherent in FHA’s mission is a responsibility to ensure that FHA loans build sustainable wealth and are widely accessible to the communities that need them. There are three provisions of H.R. 1852 that work toward this goal. First, there is the payment incentive. FHA borrowers who choose one of the riskier loan products, such as the zero downpayment product, will pay a higher premium. The payment incentive will reduce the insurance premium rates for borrowers with these products who have made timely payments for five years. It also offers a refund to high-risk borrowers for the difference between the higher and the standard rate premiums upon repayment of the loan. Second, increasing the FHA loan limits will increase the accessibility of FHA-insured loans, especially for Latinos. Many Latinos live in high-cost areas. H.R. 1852 increases the maximum principal allowed under the FHA program to the area median home price. This will allow families in high-cost markets to access FHA. Third, the cap placed on fees in the new risk-based pricing model is helpful. This ensures that FHA’s target borrower – one who is arguably more vulnerable than the average consumer – is not overcharged. While FHA must remain flexible to serve as many borrowers as possible, it also has a responsibility to protect borrowers and place them in sustainable loans.

Overall, we consider H.R. 1852 to be an improvement over the original bill from the 109<sup>th</sup> Congress (H.R. 1521). Through NHN, NCLR serves thousands of Latino borrowers who fit the target FHA profile. We understand the needs of this market. In this spirit, we offer three recommendations below to further strengthen this legislation.

- **Increase authorization levels for the HUD Housing Counseling Program to \$100 million.** Across the country, housing counselors are seeing an increased demand for their services. Many NHN organizations went from one or two calls a week to five a day from families seeking foreclosure prevention services. While we see the counseling provisions in this legislation as highly positive, we have to ensure that the counseling agency has the capacity to serve the market. Increasing rates of foreclosure also weigh heavily on the

counseling industry. We recommend an increase in counseling funds, and that portions of this increase be set aside to fund foreclosure prevention and special outreach efforts to vulnerable populations, including language minorities.

- **Solidify the incentive for borrowers to receive counseling.** Families who receive housing counseling are less likely to default. Therefore, borrowers who successfully complete homeownership counseling in a timely manner before the closing of their mortgage should receive a “discount” on their insurance premium in the form of a credit enhancement. To accomplish this, we recommend that the committee instruct HUD to consider whether a family has received counseling as part of its risk-based pricing equation. In addition, to guarantee that FHA borrowers in need of loss mitigation services actually receive them, we recommend that the loss mitigation program make homeowners’ ability to save the home when facing foreclosure HUD’s clear priority. This can be done by adjusting servicers’ fee schedules to provide at least equal compensation for loss mitigation services and a short sale or other loss of the home. HUD should penalize servicers that do not provide loss mitigation services according to HUD regulations.
- **Ensure the FHA program remains true to its social mission.** As discussed, FHA’s unique social mission is one of its strongest assets to underserved communities. As FHA seeks to expand its reach and explores a variety of origination channels, NCLR recommends that HUD institute an originator code of ethics. Through such a code of ethics, all FHA originators would pledge to uphold FHA’s mission and responsibilities. The code of ethics would serve as a quality control tool and should protect the integrity of the borrower-broker relationship, promote transparency in the mortgage transaction, prohibit pressure sales tactics, and ensure that borrowers have access to accurate and timely information regarding the price of their loan. In the past, NCLR has also recommended HUD put in place monitoring techniques similar to the tactics used by other market players, including random audits for its originators and interviews with FHA borrowers shortly after closing.

Finally, although outside the scope of this legislation, we encourage members of this committee to see their efforts to combat predatory lending as a complementary endeavor. All too often we see our families fall prey to abusive loans when they could have qualified for a safe and affordable product. Thank you.



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**HEARING BEFORE THE  
HOUSE FINANCIAL SERVICES COMMITTEE  
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY**

**ENTITLED**

**“THE EXPANDING AMERICAN HOMEOWNERSHIP ACT OF 2007:  
H.R. 1852 AND RELATED FHA MODERNIZATION ISSUES”**

**WRITTEN TESTIMONY OF  
IONA C. HARRISON, GRI**

**NATIONAL ASSOCIATION OF REALTORS®  
APRIL 19, 2007**

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### **Introduction**

Madam Chairman, Ranking Member Biggert, thank you for the opportunity to testify before the Subcommittee. My name is Iona Harrison and I am a broker with Realty Executives/Main Street USA in Upper Marlboro, Maryland. I am the 2006-2007 Secretary of the Maryland Association of REALTORS<sup>®</sup>, the immediate past Chair of the National Association of REALTORS<sup>®</sup> Housing Opportunity Advisory Board, and a member of the National Association of REALTORS<sup>®</sup> Federal Housing Policy Committee.

I am here to testify on behalf of 1.35 million members of the National Association of REALTORS<sup>®</sup>. We thank you for the opportunity to present our views on the importance of FHA mortgage insurance and the urgent need for reform. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

### **Consumers Need a Safe, Affordable Mortgage Alternative**

The current increase in foreclosures is troubling to all of us. In 2006, 1.2 million families entered into foreclosure, 42 percent more than in 2005<sup>1</sup>. Predatory lending, exotic mortgages and a dramatic rise in sub-prime lending – coupled with slowing home price appreciation - have all contributed to this crisis.

In 1934 the Federal Housing Administration was established to provide consumers an alternative during a similar lending crisis. At that time, short-term, interest-only and balloon loans were prevalent. Since its inception, FHA has insured more than 34 million properties. However, because it hasn't evolved, FHA's market share has been dropping. In the 1990s FHA loans were about 12 percent of the market. Today, that rate is less than 3 percent. This statistic is unfortunate given that FHA is needed now as much as it was in 1934. At the same time, the sub-prime market has skyrocketed. In 2003, the sub-prime market share was 8.5 percent. By 2005 it was at 20 percent. In 2006, FHA/VA market share dropped 37.8 percent; conventional loans dropped 9.8 percent; while sub-prime loans increased another 15.7 percent.

When formed, FHA was a pioneer of mortgage products. FHA was the first to offer thirty-year fixed-rate financing at a time when loans were generally for less than five years. Unfortunately, FHA has not changed with the times. Where they were once the innovator, FHA has become the lender of last resort. As conventional and sub-prime lenders have expanded their repertoire of loan products, FHA has remained stagnant. As a result, a large number of homebuyers have decided to use one of several new types of non-traditional mortgages that let them "stretch" their income so they can qualify for a larger loan.

Non-traditional mortgages often begin with a low introductory interest rate and payment—a "teaser"—but the monthly mortgage payments are likely to increase significantly in the future.

<sup>1</sup> *A Flood of Foreclosures, But Should You Invest?*, Market Watch, February 18, 2007.

Some of these loans are “low documentation” mortgages that provide easier standards for qualifying, but also feature higher interest rates or higher fees. Mortgages such as interest-only and option adjustable rate mortgages (ARMs) can often be risky propositions for some borrowers. For many of these products, the borrower is only qualified on their ability to make the initial payment amount. When the introductory period expires and monthly payments increase by as much as 50 percent or more, or when their loan balances get larger each month instead of smaller, many borrowers ability to pay will be put at risk. Mortgage experts estimate that approximately \$1.5 trillion worth of ARMs will reset by the end of 2007<sup>2</sup>. While some borrowers may be able to make the new higher payments, many will find it difficult, if not impossible.

As the market has changed, FHA must also change to reflect consumer needs and demands. If FHA is enhanced to conform to today’s mortgage environment, many borrowers would have available to them a safer alternative to the riskier products that are currently marketed to them.

#### **To Be Viable, FHA Must Reform**

To enhance FHA’s viability, legislation has been introduced that proposes a number of important reforms to the FHA single-family insurance program that NAR believes will greatly benefit homebuyers by improving access to FHA’s safe and affordable credit.

The legislation proposes to increase the loan limits, eliminate the statutory 3 percent minimum cash investment and downpayment calculation, allow FHA flexibility to provide risk-based pricing, and move the condo program into the 203(b) fund. The National Association of REALTORS® strongly supports these reform provisions.

**Loan Limits.** FHA mortgages are used most often by first-time homebuyers, minority buyers, and other buyers who cannot qualify for conventional mortgages because they are unable to meet the lender’s stringent underwriting standards. Despite its successes as a homeownership tool, FHA is not a useful product in high cost areas of the country because its maximum mortgage limits have lagged far behind the median home price in many communities. As a result, working families such as teachers, police officers and firefighters are unable to buy a home in the communities where they work. In your home state of California, Madam Chairman, FHA is virtually unusable due to the loan limits. In Representative Biggert’s state of Illinois, which is not generally considered high cost, NAR projects that the loan limit change alone will increase FHA usage by 71%, resulting in a savings of over \$41.4 million to Illinois homeowners over what they are paying for subprime loan products.

This is why NAR strongly supports proposals to change the FHA loan limits. Under the legislation, FHA’s limits for single unit homes in high cost areas would increase from \$362,790 to the 2006 conforming loan limit of \$417,000. In non-high cost areas, the FHA limit (floor) would increase from \$200,160 to \$271,050 for single unit homes. This increase will enhance FHA’s ability to assist homebuyers in areas not defined as high-cost, but where home prices still exceed the current maximum of \$200,160. This includes states such as Arizona, Colorado,

<sup>2</sup> *Homeowners Brace For ARMs' New Rates*, The Seattle Times, February 17, 2007.

Florida, Georgia, Illinois, Maine, Minnesota, Nevada, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, and Washington. While none of these states is generally considered “high cost”, all have median home prices higher than the current FHA loan limit.

**Down Payment Flexibility.** The ability to afford the downpayment and settlement costs associated with buying a home remains the most challenging hurdle for many homebuyers. Eliminating the statutory 3-percent minimum downpayment will provide FHA flexibility to offer varying downpayment terms to different borrowers. Although housing remains strong in our nation’s economy and has helped to increase our nation’s homeownership rate to a record 69 percent, many deserving American families continue to face obstacles in their quest for the American dream of owning a home. Providing flexible downpayment products for FHA will go a long way to addressing this problem.

In 2005, 43 percent of first-time homebuyers financed 100 percent of their home. NAR research indicates that if FHA were allowed to offer this option, 1.6 million families could benefit. According to NAR’s Profile of Homebuyers, 55 percent of homebuyers who financed with a zero-downpayment loan in 2005, had incomes less than \$65,000; 24 percent of those who used a zero-downpayment product were minorities; and 52 percent of people who financed 100 percent of their home purchased homes priced at less than \$150,000. It is important to note that FHA will require borrowers to have some cash investment in the home. This investment can be in the form of payment of the up-front premium or closing costs. No loan will be made for more than 103 percent the value of the home.

**Risk-based Pricing.** Another key component of the legislation is to provide FHA with the ability to charge borrowers different premiums based on differing credit scores and payment histories. Risk-based pricing of the interest rate, fees and/or mortgage insurance is used in the conventional and sub-prime markets to manage risk and appropriately price products based on an individual’s financial circumstances. Currently, all FHA borrowers, regardless of risk, pay virtually the same premiums and receive the same interest rate.

FHA financing, with risk-based premium pricing, will still be a much better deal for borrowers with higher risk characteristics than is currently available in the “near prime” or sub-prime markets. Risk-based pricing makes total sense to the private market, and should for FHA as well. Giving FHA the flexibility to charge different borrowers different premiums based on risk will allow FHA to increase their pool of borrowers. If FHA is also given authority to provide lower downpayment mortgages, premium levels will need to reflect the added risk of such loans (as is done in the private market) to protect the FHA fund.

**Changes to the Fund Structures.** The legislation also proposes to combine all single-family programs into the Mutual Mortgage Insurance Fund. The FHA program has four funds with which it insures its mortgages. The Mutual Mortgage Insurance (MMI) Fund is the principal funding account that insures traditional Section 203b single-family mortgages. The Fund receives upfront and annual premiums collected from borrowers as well as net proceeds from the sale of foreclosed homes. It is self-sufficient and has not required taxpayer bailouts.

The Cooperative Management Housing Insurance Fund (CMHI), which is linked to the MMI Fund, finances the Cooperative Housing Insurance program (Section 213) which provides mortgage insurance for cooperative housing projects of more than five units that are occupied by members of a cooperative housing corporation.

FHA also operates Special Risk Insurance (SRI) and General Insurance (GI) Funds, insuring loans used for the development, construction, rehabilitation, purchase, and refinancing of multifamily housing and healthcare facilities as well as loans for disaster victims, cooperatives and seniors housing. Currently, the FHA condominium loan guarantee program and 203k purchase/rehabilitation loan guarantee program are operated under the GI/SRI Fund.

NAR strongly supports inclusion of the FHA condominium loan guarantee program and the 203k purchase/rehabilitation loan guarantee program in the MMIF. Both of these programs provide financings for single family units and have little in common with multifamily and health facilitates programs covered by the SRI and GI funds. In recent years programs operating under the GI/SRI funds have experienced disruptions and suspensions due to funding commitment limitations. Maintaining the single family condo and purchase/rehabilitation programs under the GI/SRI funds exposes these programs to possible future disruptions. Thus, from a conceptual and accounting standpoint, it makes sound business sense to place all single-family programs under the MMIF.

**Program Enhancements.** As well as combining the 203(k) and condominium programs under the MMIF, NAR also recommends key enhancements to increase the programs' appeal and viability. Specifically, NAR recommends that HUD be directed to restore investor participation in the 203(k) program. In blighted areas, homeowners are often wary of the burdens associated with buying and rehabilitating a home themselves. However, investors are often better equipped and prepared to handle the responsibilities related to renovating and repairing homes. Investors can be very helpful in revitalizing areas where homeowners are nervous about taking on such a project.

We also recommend that HUD lift the current owner-occupied requirement of 51 percent before individual condominium units can qualify for FHA-insured mortgages. The policy is too restrictive because it limits sales and homeownership opportunities, particularly in market areas comprised of significant condominium developments and first-time homebuyers. In addition, the inspection requirements on condominiums are burdensome. HUD has indicated that it would provide more flexibility to the condo program under the MMIF. We strongly support loosening restrictions on FHA condo sales and 203k loans to provide more housing opportunities to homebuyers nationwide.

#### **FHA Protects Borrowers**

The universal and consistent availability of FHA loan products is the principal hallmark of the program that has made mortgage insurance available to individuals regardless of their racial, ethnic, or social characteristics during periods of economic prosperity *and* economic downturn.

The FHA program makes it possible for higher-risk, yet credit-worthy borrowers to get prime financing. According to a recent Federal Reserve Bank review,<sup>3</sup> the average credit score for sub-prime borrowers was 651. This is higher than FHA's median credit score borrower, which demonstrates that these borrowers are likely paying more than they need to pay. By offering access to prime rate financing, FHA provides borrowers a means to achieve lower monthly payments – without relying to interest-only or “optional” payment schemes. FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization.

When the housing market was in turmoil during the 1980s, FHA continued to insure loans when others left the market; following 9/11, FHA devised a special loan forbearance program for those who temporarily lost their jobs due to the attack; after Hurricanes Katrina and Rita, FHA provided a foreclosure moratorium for borrowers who were unable to pay their mortgages while recovering from the disaster. FHA's universal availability has helped to stabilize housing markets when private mortgage insurance has been nonexistent or regional economies have faltered. FHA is the only national mortgage insurance program that provides financing to all markets at all times. Simply put, FHA has been there for borrowers.

Now, more than ever, FHA needs to be strengthened to continue to be available to borrowers. In just the past few months, at least 25 sub-prime lenders have exited the business, declared bankruptcy, announced significant losses, or put themselves up for sale.<sup>4</sup> After making record profits, these lenders are simply bailing as the bad loans they made begin to fail. FHA, who is more careful with its underwriting standards, can be a safe alternative for buyers who have been lured into unnecessary sub-prime loans.

FHA is a leader in preventing foreclosures. FHA's loss mitigation program authorizes lenders to assist borrowers in default. The program includes mortgage modification and partial claim options. Mortgage modification allows borrowers to change the terms of their mortgage so that they can afford to stay in the home. Changes can include extension of the length of the mortgage or changes in the interest rate. Under the partial claim program, FHA lends the borrower money to cure the loan default. This no-interest loan is not due until the property is sold or paid off. In the year 2004 alone, more than 78,000 borrowers were able to retain their home through FHA's loss mitigation program; and two years later, nearly 90 percent of these borrowers are still in their homes. By encouraging lenders to participate in these loss mitigation efforts and penalizing those who don't, FHA has successfully helped homeowners keep their homes and reduced the level of losses to the FHA fund.

#### **Can FHA Help with the Current Foreclosure Crisis?**

The National Association of REALTORS® has provided HUD Secretary Jackson with a proposal that would allow FHA to help many families with recent or impending interest rate adjustments refinance into a loan they can afford. Our proposal is to allow credit-worthy borrowers who may not be “current” on their existing loan, refinance into an FHA loan.

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<sup>3</sup> Federal Reserve Bank of St. Louis Review - January-February 2006

<sup>4</sup> *The Mortgage Mess Spreads*, BusinessWeek.com, March 7, 2007.

Many homeowners who were able to make timely payments under their original terms of their loan are finding it difficult to make payments after rate adjustments. This is occurring and will continue to occur across a wide spectrum of ARM products including 2/28 and 3/27 products issued over the past few years. Many of these homeowners that would otherwise qualify for FHA insured mortgages will be preempted by guidelines that prohibit refinancing when loans are not current and will eventually be subject to foreclosure. We believe FHA can design a mechanism where creditworthy borrowers could refinance subject to prudent guidelines and avoid losing their homes. NAR believes in a strong FHA and would support efforts to ensure that only borrowers who truly have the capacity to repay receive the opportunity to refinance under such changes.

NAR also believes that many homeowners aren't aware that FHA exists as a financing option. While FHA isn't useful to many without reforms, once reformed we believe a large public awareness campaign will be necessary to fully inform homeowners of all their options. NAR pledges to be a partner in such efforts and has already demonstrated its commitment by producing a joint FHA education brochure, "**FHA Improvements Benefit You**" with FHA and HUD distributing over 50,000 copies across the nation.

We believe this is just the beginning. REALTORS® believe that financial education is an important defense to helping prevent consumers from getting into abusive mortgages that will undoubtedly be financially destructive. NAR, in partnership with the Center for Responsible Lending, has issued three consumer education brochures, "**How to Avoid Predatory Lending**," "**Specialty Mortgages: What Are the Risks and Advantages?**" and "**Traditional Mortgages: Understanding Your Options**." The brochures emphasize how important it is for consumers to make sure they fully understand how traditional and non-traditional mortgages work before deciding which is the right choice and how to avoid the pitfalls and entrapments of predatory loans.

In addition to NAR's consumer education materials, many of our state and local associations have high-profile financial education programs in partnership with cities and community groups. Some examples include:

- In Maryland, a number of local REALTOR® associations, including in Anne Arundel County, Howard County, Prince George's County, and the Greater Baltimore Board of REALTORS® have partnered with Freddie Mac to develop CreditSmart, a credit education workshop. REALTOR® instructors teach the course to renters, homebuyers, students, and others, on how to manage critical money skills. The skills that course participants obtain help point them in the right direction to managing credit and saving to buy a home.
- In 1996, the Illinois Association of REALTORS® organized the Partnership for HomeOwnership, Inc. to help assist low-income rural Illinois residents achieve the dream of homeownership. The Partnership has administered several multi-million dollar mortgage programs (in excess of \$130 million), provided pre-purchase homebuyer counseling to over 1,500 Illinois residents, and is a HUD approved housing counseling agency. The Partnership also recently oversaw the development of high school financial educational Web site at that is available both in English and in Spanish.

- In Arkansas, the Fort Smith Board of Realtors® and the city of Forth Smith have teamed up to create a homebuyer assistance program. Participants receive credit counseling and mortgage readiness education. The program also offers a five-week financial fitness course on budgeting, money management, credit and avoiding predatory lending. Since 1997, more than 200 families have purchased a home as a result of the program.

NAR stands ready to work with the FHA to not only help Americans achieve the American Dream but to keep it as well.

**Conclusion**

Thank you again for the opportunity to testify on this important issue. Now is the time when the country needs FHA. As sub-prime loans reset and real estate markets are no longer experiencing double digit appreciation; a reformed FHA would be perfectly positioned to offer borrowers a safer mortgage alternative and bring stability to local markets and local economies. The National Association of REALTORS® stands ready to work with the Congress on passage of FHA reform.

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**Testimony of**

**William P. Killmer**

**On Behalf Of the  
National Association of Home Builders**

**Before the  
United States House of Representatives  
House Financial Services Committee  
Subcommittee on Housing and Community Opportunity**

**The Expanding American Homeownership Act of 2007:  
H.R. 1852 and Related FHA Modernization Issues**

**April 19, 2007**

Introduction

Chairwoman Waters, Ranking Member Biggert, distinguished Members of the Subcommittee on Housing and Community Opportunity, on behalf of the more than 235,000 members of the National Association of Home Builders (NAHB), thank you for this opportunity to testify today on the important subject of the revitalization of the Federal Housing Administration (FHA) single family and multifamily mortgage insurance programs. My name is Bill Killmer, and I am NAHB's Group Vice President for Advocacy.

First, I want to thank you, Ms. Waters, Chairman Frank, and the Members of the Financial Services Committee, for your strong support of FHA revitalization last year. We were gratified when the House of Representatives overwhelmingly approved H.R. 5121, which, as you know, was not taken up in the Senate.

The ongoing turmoil in the subprime mortgage market has greatly increased the urgency for enactment of FHA revitalization legislation. While subprime mortgage programs have been a valuable tool in efforts to expand homeownership opportunities, some lenders have resorted to lax lending practices that have harmed borrowers and the housing finance system. The unfortunate experiences of such borrowers provides a compelling reason why FHA needs the tools to meet its mission objectives more effectively. If granted the proper authorities by Congress, FHA's single family mortgage insurance programs could insure fixed-rate, adjustable-rate, and hybrid adjustable-rate mortgage loans to borrowers with limited cash reserves and/or slightly tarnished credit and at far better terms than the subprime loans that are making adverse headlines daily.

The Relevance of the Federal Housing Administration

Since its creation in 1934, FHA has established a strong track record of innovation and achievement while insuring mortgage loans for millions of American families, many of whom would not have otherwise been able to own a home. The

concepts of the 30-year mortgage loan and loans with low downpayments were the result of FHA's pioneering efforts in years past. Today, enhanced statutory authority is needed to restore FHA as a leader in developing loan products that are helpful to and appropriate for mortgage borrowers who could otherwise end up with an inappropriate mortgage. I believe that much of the subprime mortgage hardships could have been avoided if the FHA had been in a better position to respond to changing market forces in the past few years.

The popularity and relevance of FHA's single family mortgage insurance programs have waned over the past two decades as FHA's programs have failed to keep pace with mortgage market developments and needs. In the latter part of that period, competing subprime mortgage loan programs have lured many borrowers into less advantageous mortgages. As FHA's share of the market fell from 7 percent in 1995 to less than 2 percent in 2005, the share accounted for by subprime loans surged to 20 percent. FHA's lack of responsiveness to market needs has placed some borrowers in highly risky and inappropriate loan structures, charge unreasonably high fees and interest rates, and demand onerous prepayment terms. Many of these borrowers, despite limited cash resources and/or tarnished credit, could have qualified for market-rate FHA-insured loans. In numerous instances, statutory constraints have limited FHA's ability to respond to the needs of borrowers who might have otherwise chosen FHA.

All too often, significant differences between FHA's requirements and those for conventional mortgages have been viewed by lenders, appraisers and others as a disincentive to use FHA programs. Likewise, FHA's unique and often burdensome requirements have caused many home builders to avoid using FHA's programs to build homes – including condominiums – that otherwise would have been well-suited to borrowers using FHA-insured mortgage loans.

The decline in FHA mortgage insurance activity, both in real terms and when measured against conventional loan programs, is problematic in other respects as well. For example, FHA-insured loans serve as collateral for mortgage-backed securities

guaranteed by the Government National Mortgage Corporation (Ginnie Mae), which, like the FHA, is part of the U.S. Department of Housing and Urban Development (HUD). Ginnie Mae serves a vital role in America's housing finance system by providing liquidity for lenders to offer mortgages that are insured or guaranteed by FHA and other government agencies. Because the bulk of Ginnie Mae securities are backed by FHA-insured loans, the declining trend in FHA-insured loan originations, if unabated, could call into question the viability of the Ginnie Mae program.

#### Congress Should Act Quickly to Empower FHA With the Right Tools

There are currently two comprehensive FHA revitalization proposals before the Subcommittee. In the days since these two bills were introduced, NAHB's leadership and staff have fielded numerous queries regarding this organization's support for one proposal over the other. To all, I say that the National Association of Home Builders supports FHA reform - period!

#### *Mortgage Limits*

The limit for FHA-insured mortgages is established in statute as 95 percent of the median home price of an area, within the bounds of a national ceiling and floor. FHA's single family loan limit for the 48 contiguous states is currently capped at \$362,790, which is 87 percent of the Fannie Mae / Freddie Mac conforming loan limit. This limit is too low to enable deserving potential home buyers to purchase a home in many high-cost areas. Likewise, the FHA "floor" of \$200,160, which is indexed at 48 percent of the conforming loan limit, is too low.

The artificially low FHA loan limits restrict choices for home buyers who use FHA-insured mortgage loans to the lowest echelon of available homes throughout much of the country. In many areas, FHA borrowers are precluded from considering the purchase of a new or recently-constructed home. For example, NAHB does not believe that Congress created the FHA in 1934 with the intent of constraining borrowers to homes priced only at the lowest end of the market. In fact, NAHB's Board of Directors

adopted specific policy in 2005 in support of increasing the national FHA loan ceiling up to the conforming loan limit. NAHB also supports the proposals in both H.R. 1852 and H.R. 1752, which would recalibrate local loan limits to 100 percent of the area median from the current 95 percent and increase the national floor for FHA loan limits. We believe it is entirely reasonable to allow FHA borrowers access to at least the lower half of homes in a local market.

*Mortgage Insurance Premiums and Borrower Cash Requirements*

NAHB believes that FHA can effectively serve a broad range of borrowers while acknowledging that the risk of default varies widely. In fact, some delineation in credit risk is necessary if FHA is going to prudently provide an alternative to subprime borrowers who cannot currently get reasonable loan terms on conventional mortgages. The authority to set insurance premiums that are commensurate with credit risk will open the FHA program to borrowers who currently are shut out of the mortgage market by a tightening of qualification criteria or are facing onerous and possibly inappropriate terms on alternative forms of financing. A flexible premium structure also would allow FHA to offer more attractive pricing to lower-risk borrowers and stanch the decline in its market share while improving the risk profile of its portfolio.

To be competitive and meet increasing market needs, FHA must also have greater flexibility in establishing downpayment requirements. Significant advances have occurred in mortgage credit analysis that have allowed conventional lenders to reduce upfront cash requirements while sustaining favorable loan performance. FHA needs similar tools to remain a meaningful participant in ongoing efforts to expand homeownership opportunities and in more recent forays to find appropriate financing solutions for borrowers with less than pristine credit records.

Both H.R. 1852 and H.R. 1752 contain provisions that would alter the present structure for determining the amount of cash a borrower would have to invest to qualify for an FHA-insured loan as well as the premium that would be charged on various loan structures. Either approach could work. However, both of the proposed structures are

complex. In its deliberations, NAHB encourages the Subcommittee to be mindful of the fact that the borrower cash requirements and mortgage insurance premium structures will need to be straightforward and easy for lenders and prospective borrowers to understand.

Regardless of what cash requirement and mortgage insurance premium options are eventually adopted by this Subcommittee, I encourage the Subcommittee to retain a mortgage insurance premium structure that rewards higher-risk borrowers who establish a track record of timely payments. Variations on this concept are contained within both bills.

#### *Borrower Protections*

Many borrowers who would obtain FHA-insured mortgage loans could be considered relatively unsophisticated regarding financial matters. Research has shown that pre-loan counseling can result in improved borrower loan payment performance. If counseling requirements are placed in statute, as has been proposed, it is vital that sufficient funds are appropriated on an ongoing basis for the development and maintenance of an adequate and stable, nationwide system of counselors. The Administration has proposed that \$50 million in HUD's FY2008 budget be earmarked for housing counseling. Housing counseling agencies, which are predominately non-profit organizations, need grants from HUD to provide counseling services for prospective borrowers as well as borrowers who are having difficulty meeting their financial obligations. I encourage Members of this Subcommittee to take whatever steps are needed to ensure that sufficient funds are appropriated on an ongoing basis for housing counseling.

#### *Loan Maturities*

One underlying theme of FHA's revitalization is based upon the need to increase the affordability of the home financing process for prospective home buyers. By extending the maximum loan maturity to 40 years, FHA will enable borrowers' monthly loan payments to be reduced. Unlike the interest-only loans that are currently popular, an FHA-insured mortgage loan with a 40-year maturity will ensure that some part of the

borrower's monthly payment is used to reduce the outstanding loan balance. NAHB believes that 40-year maturities will become commonplace in the not-to-distant future and that FHA should be well-positioned to meet emerging market needs.

#### *Condominium Loans*

In many communities, condominiums increasingly represent the most affordable path to home ownership. Data from the American Housing Survey show that in 2005 almost half of condominium purchasers were first-time home buyers, up from one-third in 1997. Unfortunately, FHA's requirements for condominium loans are burdensome and differ significantly from the requirements for mortgage loans that are secured by detached single family homes. For a condominium unit to be eligible to be sold to a purchaser who uses an FHA-insured loan, FHA requires the condominium developer to provide documentation related to historical and environmental reviews for the entire project. In contrast, on conventionally financed condominiums, requirements of this nature are commonly dealt with at the state or local level. Moreover, it is common to have town homes that are sold as part of a condominium located near town homes that are part of a planned unit development (PUD). In early 2003, FHA found that its PUD approval process was redundant with local governmental review practices and subsequently dropped its PUD approval requirement. FHA's condominium approval processes are similarly redundant; however, FHA has been forced to retain these because of statutory requirements.

These different requirements exist because condominiums and detached single family homes are authorized under different sections of the National Housing Act and insurance for these loans is backed by different insurance funds. NAHB has heard from its members who develop condominiums that the burden of the additional and unnecessary requirements, and the delays encountered in attempting to comply with FHA's requirements, have caused these builders who once served the FHA market to abandon the FHA program in favor of conventionally financed borrowers. NAHB has urged HUD to move condominium unit financing and the processes for accepting such loans for insurance under FHA's single family mortgage insurance program. We are very

pleased that both bills contain provisions that would unify the coverage of all of the FHA's single family mortgage insurance programs under the Mutual Mortgage Insurance Fund.

#### *Home Equity Conversion Mortgages*

FHA's Home Equity Conversion Mortgages (HECMs) allow homeowners who are at least 62 years old to access the equity in their homes without having to make mortgage payments until they move out of their home. HECMs have found increasing acceptance among seniors as a financial alternative, however, the current program cap and the unrealistically low loan limits keep FHA from serving this growing segment of the population. NAHB is glad to see that these bills would permanently remove the existing 275,000 loan volume cap while increasing the maximum loan to the Freddie Mac / Fannie Mae conforming loan limit. The proposed changes would also permit a borrower to purchase another home without incurring the costs and delays of multiple mortgage transactions, which currently is one impediment preventing seniors from using an FHA-insured HECM in the purchase of a more suitable home. NAHB also feels there should be legislative language to clarify that FHA is permitted to insure loans secured by homes less than one-year old, which are currently not eligible. These changes would help expand seniors' options in securing housing with lower maintenance and operating costs. NAHB also supports the proposal to shift the insurance for HECMs from the General Insurance Fund to the more stable Mutual Mortgage Insurance Fund.

#### *Multifamily Loan Limits*

NAHB supports the provision in Section 21 of H.R. 1852, which would give the HUD Secretary additional flexibility to increase the FHA multifamily mortgage loan limits in high cost areas. Currently, there are some areas of the country where construction costs are so high that use of the FHA programs is not possible. NAHB believes that providing this additional flexibility to the HUD Secretary would greatly improve the FHA multifamily mortgage insurance programs. With severe shortages of affordable rental housing in most of the high cost markets, this change would enable

developers to provide much-needed new affordable housing to low- and moderate-income families.

NAHB also supports Section 22, which would correct a technical deficiency having to do with appraisals related to HUD's sales of multifamily properties.

Conclusion

In closing, I would like to reiterate NAHB's strong support for FHA and its revitalization. The current leadership team at HUD has worked hard at re-establishing FHA's relevance while keeping the program financially sound, but they need Congress to empower HUD with improved tools to pursue their mission and to keep the Mutual Mortgage Insurance Fund solvent without requiring Congressional appropriations. FHA needs programs and processes now more than ever to be in the best position to assist the many thousands of borrowers who desperately need alternatives to existing subprime loans. With Congress' help, FHA will resume its long record of leadership in serving America's home buyers. Thank you, once again, for this opportunity. I welcome any questions you may have for me.

**STATEMENT OF BRIAN D. MONTGOMERY**

Assistant Secretary for Housing – Federal Housing Commissioner  
U.S. Department of Housing and Urban Development

Hearing before the Committee on Financial Services  
Subcommittee on Housing and Community Opportunity

United States House of Representatives



“FHA MODERNIZATION”

April 19, 2007

Thank you Chairwoman Waters and Ranking Member Biggert for inviting me to testify on the Administration's proposal to modernize the Federal Housing Administration.

I want to begin my testimony by thanking you for the strong support you gave to this issue in the 109<sup>th</sup> Congress, as well as your continued commitment to modernizing FHA. Last year, working together, we introduced a significant housing bill on a bipartisan basis. And our hard work paid off to the tune of 107 cosponsors, nearly evenly split from both sides of the aisle, and a resounding 415-7 vote on the floor of the House, as well as a separate 412-4 vote on the manufactured housing reforms contained in our proposal.

As you are all aware, the Federal Housing Administration was created in 1934 to serve as an innovator in the mortgage market, to meet the needs of citizens otherwise underserved by the private sector, to stabilize local and regional housing markets, and to support the national economy. This mission is still very relevant, perhaps now more so than ever.

Moreover, the FHA model represents the very best of what a government working with the private sector can and should do. Since its inception, FHA has helped more than 34 million low- to moderate-income Americans become homeowners. By operating through a private sector distribution network, FHA efficiently reaches working families in need of safe and affordable home financing. Simply put, FHA insurance protects lenders against loss, enabling these private sector partners to offer market-rate mortgages to homebuyers who would otherwise remain unserved or underserved.

FHA also protects the homebuyer, especially those who are experiencing temporary economic hardship(s). FHA offers foreclosure prevention alternatives that are unparalleled in the industry. In fiscal year 2006 more than 75,000 FHA insured borrowers facing serious default were able to retain homeownership through FHA's toolbox of foreclosure prevention options. In an environment of increasing defaults, FHA's foreclosure rate actually decreased last year. This protection against foreclosure is good for families and good for communities. It also resulted in \$2 billion in loss avoidance for the Insurance Fund, which illustrates our commitment to sound financial management.

We believe that FHA should continue to play a key role in the national mortgage market and I'm here today to make the case for changes to the National Housing Act that will permit us to continue to fulfill our critical mission.

Allow me to explain. In recent years, FHA's outdated statutory authority has left the agency out of synch with the rest of the lending industry. Over the last decade, the mortgage industry transformed itself, offering innovative new products, risk-based pricing, and faster processing with automated systems. Meanwhile, FHA continued to offer the same types of products with the same kinds of pricing, becoming less attractive to lenders and borrowers alike.

As a result, FHA's volume has dropped precipitously in housing markets all across the nation. For example, in Chairwoman Waters' district in Los Angeles, FHA's volume has dropped from 1,603 loans in 2001 to just 5 loans in 2006 (a decline of more than 99 percent or just over \$250 million). For Ranking Member Biggert, during that same time period, FHA's volume in her state dropped from 35,335 to 12,321 loans (a decline of 65 percent or \$2.3 billion).

These statistics suggest that tens of thousands of low and moderate-income families, who would have chosen FHA, instead turned to alternative methods of mortgage finance. While many of them were well-served, some were not and ended up with an expensive and sometimes risky exotic loan. We see today the unfortunate outcomes such families across the nation are experiencing.

To offer a better and more attractive mortgage product, over the last 18 months we have made significant administrative changes to FHA, streamlining and realigning operating procedures. While these changes are good and were long overdue, they are not enough, a point our industry partners have clearly conveyed to us and to you. That is why last year FHA requested that Congress amend the National Housing Act to give it the flexibility it needs to fulfill its original mission in today's ever changing marketplace.

As the dynamic mortgage market passed FHA by, many homebuyers, especially those living in higher cost states such as California, New York, and Massachusetts, to name a few, purchased mortgage products with conditions and terms they would not be able to meet.

Some homebuyers, especially those in high home cost states like California, turned to high-cost financing and nontraditional loan products to afford their first homes. While low initial monthly payments may have seemed like a good thing at the time, the reset rates on some interest-only loans are substantial and many families have been and will continue to be unable to keep pace when the payments increase. In addition, prepayment penalties often times make refinancing cost-prohibitive. According to *Mortgage Strategist*, more than \$2 trillion of U.S. mortgage debt, or about a quarter of all mortgage loans outstanding, is due for interest rate resets in 2007 and 2008. While some borrowers will make the higher payments and many others will refinance, some will struggle and some will be forced to sell or lose their homes to foreclosure. I'm sure it comes as no surprise to the people in this room that the foreclosure rate for subprime loans is higher than that of FHA loans. And I think we can all agree that foreclosures are bad for families, bad for neighborhoods, and bad for the economy as a whole.

In the context of this economic environment, we see FHA Modernization as part of the solution. FHA reform is designed to restore a choice to homebuyers who can't qualify for prime financing and more options for all potential FHA borrowers.

Moreover, the FHA bill proposes changes that will strengthen FHA's financial position, improving FHA's ability to mitigate and compensate for risk. The proposed changes would permit FHA to operate like every other insurance company in the nation,

pricing its products commensurate with the risk, as opposed to having some borrowers pay too much and some too little. Imagine if a car insurance company charged all clients the same premium – the 17-year-old teenager and a 40-year-old adult would pay the same rate. Is that fair? With a blended rate, those who know they're paying too much switch to another insurance company. That leads to a portfolio that is increasingly lopsided: too many riskier borrowers, too few safer borrowers that collectively poses greater risk to an insurance fund. This scenario, known as adverse selection is exactly what happened to FHA over the last decade. Those who were lower credit risks went elsewhere. The premium changes proposed in the Administration's proposal will restore balance to the FHA funds, providing appropriate levels of revenue to operate in a more fiscally sound manner.

While we are on the topic of the soundness of the insurance fund, I am proud to report that the Office of the Inspector General found no material weaknesses in its FY 2006 audit of the FHA, and that in January 2007, the GAO removed FHA's single family mortgage insurance programs from its high risk list – where we had been since 1994. Both of these developments reflected improvements that HUD has made in recent years in its management of property disposition contractors, its oversight of lenders, its implementation of a mortgage scorecard, and its ability to predict claims and estimate credit subsidy costs.

I know my introduction was lengthy, but I want you to understand how important FHA reform really is – for FHA, for the homebuyers we serve, and for the industry as a whole. FHA's private sector partners – the lenders, the realtors, the brokers, the home builders – want to tell their clients about the FHA alternative. They want low- to moderate-income homebuyers to have a safer, more affordable financing option. They want FHA to be a viable player again.

Now let me explain a little bit about the simple changes we're proposing. First, we're proposing to eliminate FHA's complicated downpayment calculation and three percent cash investment requirement. Before the rest of the market began offering low downpayment loans, FHA was often the best option for first-time homebuyers because it required only a minimal downpayment. But, as I said before, the market passed FHA by. According to the National Association of Realtors, last year, 43 percent of first-time homebuyers purchased their homes with *no* downpayment. Of those who did put money down, the majority put down two percent or less.

The downpayment is the biggest barrier to homeownership in this country, but FHA has no way to address the barrier without changes to its statute. FHA Modernization would permit borrowers to choose how much to invest, from no money down to one or two or even ten percent and to be charged appropriate premiums for the size of the downpayment they make.

The proposal also provides FHA the flexibility to set the FHA insurance premiums commensurate with the risk of the loans. For example, no downpayment loans would be priced slightly higher, yet appropriately, to give homebuyers a fairly-priced

option and to ensure that FHA's insurance fund is compensated for taking on the additional risk. FHA would also consider the borrower's credit profile when setting the insurance premium. FHA would charge lower-credit risk borrowers a lower insurance premium than it does today, and higher-credit risk borrowers – many of whom we are unable to reach today – would be charged a slightly higher premium. In so doing, FHA could reach deeper into the pool of prospective borrowers, while protecting the financial soundness of the FHA Fund and creating incentives for borrowers to achieve good credit ratings and save for downpayments.

A slightly higher premium would increase a borrower's monthly payment only minimally. For example, on a \$225,000 loan, a 1 percent upfront premium financed into the loan would cost the borrower \$13.97 per month; a 2 percent premium would cost \$27.94 and a 3 percent premium, \$41.90. Clearly, this higher premium is still affordable. Moreover, it's a smart investment, because the borrower is paying for the FHA insurance to obtain a market rate loan.

Some say that with a risk-based pricing approach FHA will target people who shouldn't be homebuyers and charge them more than they should pay. I want to address these concerns directly. Our goal is to reach families who are capable of becoming homeowners and to offer them a safe and fairly-priced loan option.

With a risk-based premium structure, FHA can reach hard-working, credit-worthy borrowers – store clerks, bus drivers, librarians, first responders, social workers – who, for a variety of reasons, do not qualify for prime financing. Some have poor credit scores due to circumstances beyond their control, but have put their lives back together and need a second chance. For some, the rapid appreciation in housing prices has simply outpaced their incomes. Many renters find it difficult to save for a downpayment, but have adequate incomes to make monthly mortgage payments and do not pose a significant credit risk. They simply need an affordable financing vehicle to get them in the door. FHA can and should be there for these families.

If granted, FHA's new legislative authorities would save homeowners a lot of money, because FHA's loan product would carry a lower interest rate than a non-prime loan product. The higher premiums that FHA will charge some types of borrowers are still substantially lower than they would pay for subprime financing. For example, if FHA charged a 3 percent upfront insurance premium for a \$225,000 loan to a credit-impaired borrower versus that same borrower obtaining a subprime loan with an interest rate 3 percent above par, the borrower would pay over \$300 more in monthly mortgage payments with the subprime loan and over \$137,000 more over the life of the loan. In addition, FHA borrowers do not have to be concerned about teaser rates, unmanageable interest rate increases or prepayment penalties.

So while FHA may charge riskier borrowers more (and safer borrowers less) than it does today, the benefit is four-fold. First, FHA will be able to reach additional borrowers the agency can't serve today. Second, many borrowers will pay less with FHA than with a subprime loan. Third, the FHA Fund will be managed in a financially sound

manner, with adequate premium income to cover any expected losses. Finally, borrowers will be rewarded for maintaining good household financial practices that lead to good credit ratings and higher savings for a downpayment.

Another change proposed in FHA Modernization is to increase FHA's loan limits. Members of Congress from high-cost states have repeatedly asked FHA to do something about our antiquated loan limits. This proposal answers those concerns. FHA's loan limit in high-cost areas would rise from 87 to 100 percent of the GSE conforming loan limit; in lower-cost areas, the limit would rise from 48 to 65 percent of the conforming loan limit. In between high- and lower-cost areas, FHA's loan limit will increase from 95 to 100 percent of the local median home price. This change is extremely important and crucial in today's housing market. In many areas of the country, the existing FHA limits are lower than the cost of new construction. Buyers of new homes can't choose FHA financing in these markets. In other areas, most notably California, FHA has simply been priced out of the market.

Let me repeat a point I made earlier in the testimony. I want to assure you that the changes we are proposing will not impose any additional budgetary cost. We are proposing to manage the Fund in a financially prudent way, beginning with the change in FHA pricing to match premiums with risk. This will avoid FHA being exposed to excessive risk, as it is today, because some borrowers who use FHA are under-charged for their risk to the Fund while those who are overcharged are fleeing from the program. Of course, we will continue to monitor the performance of our borrowers very closely, and make adjustments to underwriting policies and/or premiums as needed.

I know I've talked a lot here today, but I want to convey to you how passionate I am about the proposed changes. I believe we have an opportunity to make a difference in the lives of millions of low- and moderate-income Americans. We have a chance to bring FHA back into business, to restore the FHA product to its traditional market position. And when people ask me why we are proposing these changes, I tell them these exact words: "Families need a safe deal, at a fair price. Families need a way to take part in the American Dream without putting themselves at risk. Families need FHA."

I want to thank you again for providing me the opportunity to testify here today on modernizing the Federal Housing Administration. I look forward to working with all of you to make these necessary reforms a reality.



**Statement of John M. Robbins, CMB**  
**Chairman,**  
**Mortgage Bankers Association**  
**Before the**  
**Subcommittee on Housing and Community**  
**Opportunity**  
**Committee on Financial Services**  
**United States House of Representatives**  
**Hearing on**  
**The Expanding American Homeownership Act of**  
**2007: H.R. 1852 and Related FHA Modernization**  
**Issues**  
**April 19, 2007**

Chairwoman Waters and Ranking Member Biggert, thank you for holding this hearing and inviting the Mortgage Bankers Association (MBA)<sup>1</sup> to share its views with the Subcommittee on H.R. 1852, the "Expanding American Homeownership Act of 2007," and other issues related to the modernization of the Federal Housing Administration (FHA). My name is John Robbins and I am the Managing Director and Special Counsel of Wachovia Securities Wholesale Mortgage Business, and Chairman of the Mortgage Bankers Association (MBA). Formerly, I was Chief Executive Officer of American Mortgage Network (AmNet), a wholesale mortgage bank I co-founded which is based in San Diego. AmNet was acquired by Wachovia Bank in 2005, and continues to operate as a part of Wachovia's Corporate and Investment Bank. I am here today because MBA believes Congress must act to make important legislative changes to the National Housing Act if the FHA is to continue to be a financially sound tool for lenders to use in serving the housing needs of American families who are not served or are underserved by conventional markets.

When I started in the mortgage business, the programs of FHA were invaluable in enabling us to serve families who otherwise would have no other affordable alternative for financing their home. I have spent over 36 years working with FHA and have made billions of dollars in loan originations to families who have become homeowners as a result of FHA's programs. We worked hard to be a good partner with FHA in administering its programs and, together, FHA and AmNet enabled thousands of families to purchase their first home.

Today, though, the story is very different. While my company has grown significantly, our ability to use the FHA program has declined precipitously. In 2003, FHA made up approximately 16 percent of our overall production. Last year, however, only a little more than 1 percent of our business went to FHA.

While most lenders have been able to adapt quickly to changes in the mortgage markets, FHA has been prevented from doing so. The needs of low- and moderate-income homebuyers, of first-time homebuyers, of minority homebuyers, and of senior homeowners have changed. FHA's programs, though, have not followed their historic path of adaptation to meet these borrowers' changing needs.

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

The numbers are troublesome. In 1990, 13 percent of total originations in the U.S. were FHA-insured mortgages. Currently, that number has dropped to under 3 percent.<sup>2</sup> More importantly, in 1990, 28 percent of new home sales (which are typically a large first-time homebuyer market) were financed through programs at FHA or the Department of Veterans Affairs (VA); today that number has dropped to under 12 percent.

MBA cites these numbers not because we believe that there is a certain market share that FHA should retain, but rather because these numbers are consistent with many lenders' views that FHA has not kept up with changes in the market. These numbers point to a decline, not just in market share, but in FHA's potential to positively impact homeownership. This loss of impact does not stem from the fact that FHA is no longer relevant, but rather that statutory constraints prohibit FHA from adapting its relevance to consumer needs today.

A recent anecdote illustrates this point very well. A story ran in *RealtyTimes*<sup>®</sup> almost two years ago, on June 21, 2005, in which a Baltimore, Md. real estate agent unabashedly advises homebuyers to avoid FHA financing. The agent states: "Approved FHA loan recipients, same notice to you, don't bother bringing it to the table during a sellers market. More times than not, your offer will be rejected. We know that VA and FHA loans allow you the means of purchasing more home for the mortgage, but it only works if you are the only game in town." His advice was based on the often true notion that FHA-insured financing is slower and more laborious than conventional financing, which means FHA's valuable programs are not reaching the people they should.

#### **FHA Background**

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

FHA offers multifamily and single-family insurance programs that work through private lenders to extend financing for homes. FHA has historically been an innovator. Over the past several decades, the mission of FHA's single-family programs has increasingly focused on expanding homeownership for those families who would otherwise either be unable to obtain financing or obtain financing with affordable terms. FHA's multifamily programs have allowed projects to be developed in areas that otherwise would be difficult to finance and

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<sup>2</sup> Source: *Inside Mortgage Finance*, March 2, 2007.

provides needed rental housing to families that might otherwise be priced out of a community.

Additionally, the FHA program has been a stabilizing influence on the nation's housing markets due to the fact that it is consistently available under the same terms at all times and in all places. FHA does not withdraw from markets.

### **The Need for FHA Today and Tomorrow**

The FHA single-family programs are vital to many homebuyers who desire to own a home but cannot find affordable financing to realize this dream. While the FHA has had a number of roles throughout its history, its most important role today is to give first-time homebuyers the ability to climb onto the first rung of the homeownership ladder and to act as a vehicle for closing the homeownership gap for minorities and low- and moderate-income families.

Despite this country's recent record high levels of homeownership, not all families share in this dream equally. As of the fourth quarter of 2006, the national homeownership rate stood at 68.7 percent, but only 51 percent of minorities owned their own home. Only 48.2 percent of African-Americans and 49.5 percent of Latinos owned their own homes. This compares with 76 percent of non-Hispanic white households.

By the end of 2006, 84.5 percent of families earning more than the median income owned their own home, while only 52.9 percent of families below the median income owned their own home.<sup>3</sup>

These discrepancies are tragic because homeownership remains the most effective wealth-building tool available to the average American family.

### **FHA's Record**

More than any other nationally available program, during the 1990s, FHA's impact focused on the needs of first-time, minority, and/or low- and moderate-income borrowers.

In 1990, 64 percent of FHA borrowers using FHA to purchase a home were first-time homebuyers. Today, that rate has climbed to about 80 percent. In 1992, about one-in-five FHA-insured purchase loans went to minority homebuyers. That number in recent years has grown to more than one-in-three. Minorities make up a greater percentage of FHA borrowers than they do conventional market borrowers.

FHA is particularly important to those minority populations experiencing the largest homeownership gaps. According to recent data provided by HUD, both

<sup>3</sup> Source: U.S. Census Bureau, Housing and Household Economic Statistics Division

first time homebuyers and minorities continue to make up a significant portion of FHA's customer base. To date in FY 2007, FHA has insured 115,624 purchase mortgages and 91,702, or 79.3 percent, went to first time homebuyers. Minorities have received 28,762 FHA-insured mortgages, or 31.4 percent<sup>4</sup>

Data also demonstrates FHA's tremendous service to those American families earning near or below the national median income. Ironically, as the above numbers reveal, FHA's mission to serve underserved populations has become increasingly focused during the same period as the decline in FHA's presence in the market. FHA's impact is being lost at the very time when it is needed most. The result is that American families are either turning to more expensive financing or opting not to buy a home.

It is crucial that FHA keep pace with changes in the U.S. mortgage markets. While FHA programs can be the best and most cost-effective way of expanding lending to underserved communities, we have yet to unleash the full potential of these programs to help this country achieve important societal goals.

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

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

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

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

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<sup>4</sup> Source: *FHA Outlook*, March 1-15, 2007

FHA has a strong history of innovating mortgage products to serve an increasing number of homebuyers. FHA was the first nationwide mortgage program; the first to offer 20-year, 25-year, and finally 30-year amortizing mortgages; and the first to lower downpayment requirements from 20 percent to ten percent to five percent to three percent. FHA has always performed a market stabilizing function by ensuring that mortgage lending continued after local economic collapses or regional natural disasters when many other lenders and mortgage insurers pulled out of these markets.

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

#### **Unleashing FHA's Potential**

In reviewing the status of FHA over the past decade, MBA has come to the conclusion that FHA faces severe challenges in managing its resources and programs in a quickly changing mortgage market. These challenges have already diminished FHA's ability to serve its public purposes and have also made it susceptible to fraud, waste and abuse. Unaddressed, these issues will cause FHA to become less relevant, and will leave families served by its programs with no alternative for homeownership or affordable rental housing.

In the fall of 2004, MBA formed a *FHA Empowerment Task Force* comprised of MBA member companies experienced in originating single-family and multifamily FHA loans. The Task Force discussed the long-term issues confronting FHA with the goal of developing legislative proposals that would empower it to manage its programs and policies more effectively.

The Task Force identified FHA's inability to efficiently develop products, higher costs of originations, lessening prominence in the market, out-dated technology and adverse selection as problems for FHA. Per the Task Force's recommendations, MBA proposed the following three steps to unleash FHA from overly burdensome statutory processes and restrictions, and to empower FHA to adopt important private sector efficiencies:

1. FHA needs greater autonomy to make changes to its programs and to develop new products that will better serve those who are not being adequately served by others in the mortgage market.

2. FHA needs the ability to use a portion of the revenues generated by its operations to invest in the upgrade and maintenance of technology to adequately manage its portfolios and interface with lenders.
3. FHA needs greater flexibility to recruit, manage and compensate employees if it is to keep pace with a changing financial landscape and ensure appropriate staffing to the task of managing \$450+ billion insurance funds.

#### *Flexibility to Create Products and Make Program Changes*

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

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

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

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

MBA's comments urged that, if passed prior to final rulemaking, the 5/1 cap fix be included in the final rule.

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

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

#### *Ability to Invest Revenues in Technology*

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

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

MBA believes FHA cannot create and implement technological improvements because it lacks sufficient authority to use the revenues it generates to invest in technology.

Improvements to FHA's technology will allow it to improve management of its portfolio, garner efficiencies and lower operational costs, which will allow it to reach farther down the risk spectrum to borrowers currently unable to achieve homeownership. MBA believes that such an investment would yield cost savings to FHA operations far in excess of the investment amount.

#### *Greater Control in Managing Human Resources*

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

MBA believes the above three changes will allow FHA to become an organization that can effectively manage risk and self-adapt to shifting mortgage market conditions while meeting the housing needs of those families who continue to be not served or underserved today.

#### **Legislative Activity in the 110<sup>th</sup> Congress**

MBA supported much of the FHA legislation before the 109th Congress, and I would like to take a moment to offer our perspective on various provisions contained in recently introduced pieces of legislation.

Overall, MBA is very pleased with the steps both H.R. 1852 and H.R. 1752 would take towards providing FHA with the authority necessary to make its products viable options for consumers. Both proposals provide for flexible downpayments, flexible risk-based premiums, an increase in mortgage limits, an extension of mortgage terms, reform of FHA's condominium program, and changes to the Home Equity Conversion Mortgage (HECM) program. MBA would like to review a number of provisions that are a part of those bills.

#### *Raising Maximum Mortgage Limits for High Cost Areas*

Both H.R. 1852 and H.R. 1752, if enacted, would raise FHA's maximum mortgage limits to 100 percent of an area's median home price (currently pegged at 95 percent) and raise the ceiling to 100 percent of the GSEs' conforming loan limits (currently limited to 87 percent) and the floor to 65 percent (currently 48 percent). There is a strong need for FHA financing to be relevant in areas with high home prices. MBA supports these increases because raising the limits to the GSEs' conforming limits in these areas strikes a good balance between serving a greater number of borrowers and taking on additional risk.

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

#### *Downpayment Requirements*

MBA supports the elimination of the complicated formula for determining the downpayment that is currently detailed in statute. The calculation is outdated and unnecessarily complex. The calculation of the downpayment alone is often cited by loan officers as a reason for not offering the FHA product. Both H.R. 1752 and H.R. 1852's revised downpayment calculations make significant progress towards addressing this issue.

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

MBA is pleased that both legislative proposals provides downpayment flexibility. We believe that FHA should be empowered to establish policies that would allow borrowers to qualify for FHA insurance with flexible downpayment requirements and decide the amount of the cash investment they would like to make in purchasing a home. We stand ready to work with this Congress to ensure that such flexibility maximizes homeownership opportunities for underserved communities without compromising the safety and soundness of FHA.

#### *Adjusting Mortgage Insurance Premiums for Loan Level Risk*

MBA believes that FHA would be able to serve more borrowers, and do so with lower risk to the MMIF, if they are able to adjust premiums based on the risk of

each mortgage they insure. A flexible premium structure could also give borrowers greater choice in how they utilize the FHA program.

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

A current example of this would be the fact that borrowers receiving a gift of the downpayment on a FHA-insured mortgage are charged the same premium as a borrower who puts down three percent of their own funds, despite the fact that FHA's experience indicates that the former represents a higher risk loan. FHA could better address such a risk in the MMIF by charging a higher MIP to offset some of the additional risk that such a loan poses. In this manner, while a borrower receiving a gift of funds for the downpayment will still receive the benefits of FHA financing, they themselves would share some of the risk, rather than having the risk born solely by those making a three percent downpayment.

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

#### *Lengthening Mortgage Term*

H.R. 1852 and H.R. 1752 would authorize FHA to develop products with mortgage terms up to 40 years. Currently, FHA is generally limited to products with terms of no more than 30 years. Stretching out the term will lower the monthly mortgage payment and allow more borrowers to qualify for a loan while remaining in a product that continues to amortize. MBA supports lengthening the mortgage terms and believes FHA should have the ability to test products with these features and, based on performance and homebuyer needs, to improve or remove such products.

#### *Improvements to the Reverse Mortgage Program*

MBA supports H.R. 1852 and H.R. 1752's proposed changes to the FHA's Home Equity Conversion Mortgage (HECM) program: the permanent removal of the current 250,000 loan cap and the creation of a single, national loan limit for the HECM program. The HECM program has proven itself to be an important financing product for this country's senior homeowners, allowing them to access the equity in their homes without having to worry about making mortgage payments until they move out. The program has allowed tens of thousands of senior homeowners to pay for items that have given them greater freedom, such

as improvements to their homes that have allowed them to age in place, or to meet monthly living expenses without having to move out of the family home.

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

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

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

#### *Improvements to FHA Condominium Financing*

MBA supports both of these legislative proposals to move FHA's coverage of condominium units from the General Insurance Fund to the Mutual Mortgage Insurance Fund. It is unfortunate to note that FHA insurance on condominium units has dropped at a higher rate than the overall decline in FHA's originations. This decline contradicts the fact that in costly markets, condominium units are typically the primary type of housing for first-time homebuyers. FHA should have a much bigger presence in the condominium market.

As this Committee moves the process of FHA reform forward, there are issues that I would like to bring to your attention that warrant particularly close consideration.

*The Definition of "Higher-Risk" Borrowers*

H.R. 1852 would create a category of "Higher-Risk" borrowers, defined as those borrowers with a Fair Isaac Corporation ("FICO") score of less than 560. MBA, as outlined above, supports the principle of recognizing that different borrowers carry different risks and that those risks should be priced appropriately. Tying the definition of that risk to a specific FICO score, however, may create unanticipated problems for borrowers in the future. Though the FICO score is widely recognized as a powerful tool to determine an individual's credit risk, it is the product of a proprietary algorithm owned solely by Fair Isaac that is not subject to any oversight and is constantly being adjusted. As a result, a score of 560 does not represent the same risk it did ten years ago, and it likely won't represent the same risk ten years from today. But once Congress establishes a specific credit score as a standard, it will take another act of Congress to adjust that standard in the face of an evolving marketplace. MBA suggests giving the Secretary authority to set underwriting and corresponding pricing standards for a "Higher-Risk" category so that borrowers in the future will not have to wait on the sometimes cumbersome Congressional process.

*Creation of an Affordable Housing Fund*

H.R. 1852 would authorize the creation of an Affordable Housing Grant Fund. This Fund would be financed by any excess revenue generated by higher mortgage insurance premium (MIP) limits and lifting the Home Equity Conversion Mortgage program limitation caps. Though the goal—more affordable housing—of this proposed fund is certainly laudable, MBA does not believe the Fund provides the most efficient means to achieve more affordable housing and may slow passage of this important legislation.

MBA notes with great concern the Administration's Fiscal Year 2008 Budget proposal released in February which estimates that the FHA mortgage insurance fund will go into the red in fiscal year 2008 unless changes to the existing program are made or budget authority to provide additional credit subsidy is given to the Agency. In response to the expected increased costs associated with higher defaults and lower originations, the Administration projects increases in the up-front MIP from 150 basis points (1.5 percent) to 166 basis points will be needed. In addition, the annual MIP is assumed to increase from 50 basis points to 55 basis points. On a \$200,000 loan, this is an extra \$320 (from \$3,000 to \$3,321) due at the closing table and an additional \$100 (from \$1,000 to \$1,100) the borrower must pay each year for the same loan. This may not seem like a lot of money, but for your typical FHA borrower—who is likely to be trying to purchase their first home and may not have much in the way of a savings—this could be the difference between owning a home or continuing to sit on the sidelines of homeownership.

The Federal assistance that FHA provides to low- and moderate-income households provides critical support for extending homeownership possibilities that the private market cannot fully address. Since no additional budget authority to cover these costs were included in the Budget, the FHA would need to either raise premiums, curtail credit to some borrowers who today could get loans, or some combination. We note that even with the passage of comprehensive reform legislation envisioned last year, the Administration's estimates conclude that premium increases may be necessary. In that light, rather than diverting any excess premium revenue resulting from this legislation to a separate fund, MBA believes that the most effective way to lower the cost of homeownership is to return that money to homeowners through lower insurance premiums.

MBA would also like to applaud legislation introduced in the Senate, S. 947, the "21st Century Housing Act." This bill contains the following MBA-supported provisions:

*Investment in FHA Infrastructure – Human Resources*

MBA supports authorizing the Secretary of HUD to appoint and fix the compensation of FHA employees and officers. S. 947 calls on the Secretary to consult with, and maintain comparability with, the compensation of officers and employees of the Federal Deposit Insurance Corporation. While MBA has similar concerns as outlined above regarding the funding mechanism detailed in the bill for this provision, we firmly believe that giving FHA greater flexibility in investing in its human capital is critical if it is to attract and retain the talent it needs to become a stronger and more effective program serving the needs of our nation's homeowners and renters.

*Investment in FHA Infrastructure – Information Technology*

Again, MBA strongly supports investment in FHA's information technology. S. 947, if enacted, would authorize funding to pay for much needed technology improvements. While MBA would rather see any potential excess funding used to lower premiums, MBA believes that upgrading FHA's technology is critical to improving FHA's management of its portfolio and lowering its operational costs. MBA also believes that such an investment will allow FHA to reach farther down the risk spectrum to borrowers currently unable to achieve homeownership.

**Additional FHA Issues**

*Treatment of FHA Non-Conveyable Properties*

On March 21, 2007, the House passed H.R. 1227, the "Gulf Coast Hurricane Housing Recovery Act of 2007." This bill provides critical relief to mortgage servicers who hold title on damaged properties in the Gulf Coast. FHA provides credit insurance against the risk of foreclosure losses associated with loans

originated according to FHA standards. FHA generally pays an insurance claim when it takes title (conveyance) to a property as a result of foreclosure. To convey a property and receive insurance benefits, however, FHA requires that the property be in "conveyance condition" (i.e., repaired and saleable condition). Properties that have sustained damage attributable to fire, flood, earthquake, tornado, hurricane, boiler explosion (for condominiums), or the lender's failure to preserve and protect the property are not eligible for insurance benefits unless they are repaired prior to conveyance of the property to the FHA. While HUD has in the past accepted properties in "as is" (damaged) condition on a case-by-case basis, this is rarely done. Moreover, HUD will deduct from the "as is" claim the estimated cost of repair. HUD should accept conveyance of damaged properties and not adjust the claim for the cost of repair when there was no failure on the part of the servicer to obtain hazard or flood insurance pursuant to federal law. In addition, to the extent that a property is not conveyable or has other problems (i.e., condemned, demolished by local, state, or federal government or there is concern about environmental issues that preclude a private servicer from taking title to the property), HUD should be permitted to pay the full claim without the servicer taking conveyance of the property or HUD taking conveyance of the property. At this time, MBA does not believe HUD has the statutory authority to manage claims in this manner. MBA applauds the House's swift action on this issue, and urges the Senate to pass H.R. 1227, especially in light of HUD's and Louisiana's actions to revamp the Road Home grant program in a manner that no longer promotes rebuilding. This decision exacerbates servicers' losses.

#### *FHA Multifamily Programs*

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

While the FHA has implemented a number of significant improvements to its single-family program over the last two years, the same focus needs to be applied to improving the multifamily programs. MBA hopes that process improvements on the multifamily side of FHA will soon be discussed and implemented.

MBA is particularly pleased by the provision in H.R. 1852 to raise the mortgage limits in high cost areas from 140 percent and 170 percent, respectively, to 170 percent and 215 percent. In the face of rapidly rising building costs in many of

the nation's cities, this increase is necessary to allow developers to continue providing affordable housing in those areas that need it the most.

#### *Response to Natural Disasters*

Hurricane season will again be upon us. The disasters of Hurricanes Katrina and Rita point to the need for a financially solvent FHA that is not restricted by onerous processes and procedures. The FHA program must be ready to assist homeowners and renters who lost everything amid the destruction of the hurricanes. It must have the necessary wherewithal to step in and help work out the existing mortgages in disaster areas. FHA must have the programs necessary to meaningfully assist in the rebuilding effort. Giving FHA the mechanisms to fund adequate technology improvements, flexibilities in managing human resources, and greater authority to introduce products will ensure FHA can step in to help communities when disasters occur. It is critical that Congress act quickly to ensure that FHA is adequately prepared to help homeowners and renters before the next major disaster strikes.

#### *Seller Funded Gift Programs*

Without Congressional action this year, many families face a serious risk of being unable to access FHA financing due to a recent ruling by the Internal Revenue Service (IRS). On May 4, 2006, the IRS released Revenue Ruling 2006-27, which may lead the IRS to rescind the nonprofit status of a large number of organizations who receive funding from property sellers in providing downpayment assistance to FHA borrowers. FHA regulations require that nonprofits providing a downpayment gift have an IRS nonprofit exempt status. Due to the ruling, the IRS has indicated that it is investigating 185 organizations which provide downpayment assistance.

MBA expects this ruling to have a dramatic effect on FHA's purchase production. Before the ruling, more than one-third of FHA purchase loans had some type of downpayment assistance. Such programs currently serve tens of thousands of FHA's primary clientele: first-time homebuyers, low- and moderate-income families and minorities.

#### **Conclusion**

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

to provide these consumers with affordable, viable lending options needed to help them achieve homeownership.

On behalf of MBA, I would like to thank the Subcommittee for the opportunity to present our views on the important programs offered by FHA. MBA looks forward to continuing to work with Congress and HUD to improve FHA's long-standing mission and ability to serve aspiring homeowners and those seeking affordable rental housing.



**California Association of Mortgage Brokers**

**Prepared Testimony of**

**Ed Smith, Jr., Vice President, Government & Industry Relations**

**Vice President, Board of Directors,**

**California Association of Mortgage Brokers**

**On FHA Modernization: H.R. 1852**

**Before the**

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

**United States House of Representatives**

**April 19, 2007**

Good morning Chairwoman Waters and members of the subcommittee, I am Ed Smith, Jr., Government Affairs Committee Chair and Vice President of the Board of Directors of the California Association of Mortgage Brokers ("CAMB"). Thank you for inviting me to testify today on the Federal Housing Administration Modernization legislation, H.R. 1852. In particular, we appreciate the opportunity to address the need to: (1) increase Federal Housing Administration (FHA) loan amounts for high-cost areas, (2) develop risk-based pricing for mortgage insurance on FHA loans, and (3) reform the FHA program to reduce the barriers to mortgage broker participation.

Since its inception in 1990, the California Association of Mortgage Brokers has promoted the highest standards of professional and ethical conduct, among which are expert knowledge, accountability, fair dealing, and service to the consumer and our community. The Association provides education, legislative and regulatory representation, and public relations for its 4,000 plus membership of mortgage brokers

and affiliated service providers across California, while serving as a forum for the development of common business interests across the industry. CAMB has led the mortgage industry by being the first organization to define predatory lending, as well as creating a best practices handbook that has set the standard for best practices in the industry.

CAMB has also raised the bar for consumer protection by creating the Consumer Protection and Education Worksheet, a document which allows both borrower and broker to sign at the bottom to affirm that they have been educated and fully understand all terms of their loan. CAMB has a proactive legislative agenda which recently passed into law two CAMB sponsored bills, AB 790 and 2890, which outlaw the misrepresentation of training and professional certifications by loan originators in the state of California. As you can see, CAMB has aggressively pushed for best practices in the industry and is dedicated to being a solution to curb predatory lending practices, standardize the industry from within, and provide the best products available to our customers, including alternative loan products.

The utilization of non-prime mortgage products rose exponentially, especially in high-cost areas such as California, as FHA programs became less and less accessible to the public. CAMB believes that the proposed reforms to the FHA program in H.R. 1852 are critical to expanding homeownership opportunities for prospective first-time, minority, and low to moderate-income homebuyers, and vital to solving the liquidity crisis in the marketplace caused by the recent turmoil in the non-prime marketplace.

#### **Increase FHA Mortgage Amounts for High-Cost Areas**

CAMB strongly believes the formula used to calculate FHA maximum loan amounts should be revised to make the FHA program accessible to those homebuyers living in high-cost areas. The benefits of the FHA program should belong equally to all taxpayers; especially those residing in high-cost areas that often are most in need of affordable mortgage financing options.

For example, in California, twenty-nine of the fifty-eight counties are currently at the FHA ceiling of \$362,790, with another six counties approaching the ceiling when one factors in the latest escalation in home prices. These twenty-nine counties represent approximately eighty-five percent of California's population, many of whom are struggling to become or remain homeowners in an area where the median house price is currently \$535,470. California is not alone. High-cost areas exist in many states across the country. Maryland, for example, has five of twenty-four counties currently at the \$362,790 FHA maximum with another seven counties within \$1,885 of the limit. Again, these counties represent a great majority of the population for Maryland. Additional states that currently feature counties at or approaching the maximum FHA loan limit include Pennsylvania, Connecticut, New York, and New Jersey among others.

Recognizing high-cost areas with regard to FHA loan limits is not new to this legislative body. Congress already recognizes high-cost areas for FHA loan limits in Hawaii, Alaska and various United States Territories. These areas feature an exception that takes their available loan limit to one hundred and fifty percent of the current FHA loan limit.

We must not forget that the FHA program was created by the National Housing Act of 1934 with the intent of increasing homeownership and assisting the home building industry. Since its inception, FHA has insured over 33 million loans and is the largest insurer of mortgages in the world. FHA insured loans are the staple for first-time homebuyers. FHA insured loans are more accommodating to first-time homebuyers than other types of loan programs. The program is designed to incorporate flexibility for debt-ratios, income and credit history items not included in the government sponsored enterprise (i.e., Fannie Mae and Freddie Mac) guidelines.

#### **FHA Risk-Based Premiums are Relevant to the Market**

The ability to match borrower characteristics with an appropriate mortgage insurance premium has been recognized as essential by every private mortgage insurer ("PMI"). PMI companies have established levels of credit quality, loan-to-value and protection coverage to aid in this matching process. They also offer various programs that allow for upfront mortgage insurance premiums, monthly premiums or combinations of both. This program flexibility has enabled lenders to make conventional loans in the private marketplace that either are not allowable under FHA or that present a risk level that is currently unacceptable to FHA.

Unfortunately, where FHA is not available as a viable competitor, PMI premiums are quite expensive. Should FHA decide to enter this market, it will increase competition for these programs and ultimately, drive down costs for borrowers.

For example, many mortgage products that require minimal or no down payment or equity do not use PMI insurance. Rather, these loans are split into two—a first mortgage, which is offered at a lower interest rate, and then a second mortgage offered at a considerably higher interest rate. This "combo" or "80/20" type of mortgage product is commonly offered to borrowers with less than perfect credit. Borrowers who are unable to adequately prove their income also commonly utilize "combo" mortgages. In this market, PMI may not be offered or is offered at a prohibitively high premium. Again, FHA could act as a competitor to drive down costs for these types of products.

PMIs have demonstrated the ability to balance risk with the premiums charged and the FHA program should be afforded the same opportunity. If the risks are assessed appropriately, the premiums charged should ensure that the Mutual Mortgage Insurance Fund ("MMIF") will not be adversely affected. FHA is not required to make a suitable profit or demonstrate market growth to shareholders; therefore, it is likely that

FHA can afford to assume even greater risk levels than PMIs can currently absorb. This increased capacity to assume and manage risk will allow FHA to serve even those borrowers who presently do not have PMI available as a choice.

H.R 1852 allows FHA to offer lower premiums to lower credit risk homebuyers, which will have the net effect of reducing the overall default rates at FHA. Recent changes made by HUD such as permitting formerly non-allowable fees to be charged and utilizing Fannie Mae appraisal guidelines have had the effect of modernizing the FHA program. These advances make the FHA program easier to use, which in turn attracts more borrowers who would not otherwise tolerate the red-tape long-associated with origination of FHA loans. Real estate agents, sellers and mortgage companies who have not viewed FHA financing as a viable alternative to the private marketplace would also return to the program, bringing with them suitable borrowers that would make FHA's default rate comparable to that of conventional loans.

This legislation is not intended to be a change to the FHA program that will create losses. Rather, it is designed to avoid losses to the MMIF. The legislation contains needed reforms that will help FHA meet its chartered mandate of increasing homeownership opportunities for first-time, minority and low to moderate-income homebuyers, and which may actually have the side effect of improving the solvency of the MMIF.

All insurance constructs involve assumption of risk. When an insurer can use sound actuarial data and price in a manner that is responsive to trends revealed by such data, the risk is spread over a sufficiently large base to minimize the chance of loss. Because FHA's share of the market is approaching marginal levels, the risks to the program are likely to be greater under the status quo than with the legislation proposed in H.R. 1852.

**Benefits to Consumers, Particularly First-Time HomeBuyers, Minority and Low to Moderate-Income Families**

Lenders and insurers tend to demand a higher proportional return when they enter a riskier market. It has been demonstrated that the return demanded is considerably higher for sub-prime loan products than for prime loans because of the inherent risks presented by the sub-prime market. At the same time, consumer advocates have claimed that fees and rates for many sub-prime borrowers are too high. FHA has the ability to enter into the sub-prime market safely and still offer significant savings to prospective borrowers. The benefits received by expanded FHA entry into the sub-prime market would be particularly useful for first-time, minority and low to moderate-income homebuyers who could receive prime interest rates on their loans by using FHA insurance.

The FHA program also possesses many attributes that are particularly friendly to prospective borrowers who may have less money available for closing costs, temporary income, or a limited credit history. For example, FHA Direct Endorsement Underwriters are given considerable latitude to make loans that they believe should be made, but may not have all of the requisite attributes conventional guidelines require. FHA servicing is far less likely to quickly send a loan to foreclosure and must follow borrower-friendly practices whereas some conventional lenders have been cited for questionable loan servicing practices. FHA loans usually offer fixed interest rates compared to the adjustable rates offered on most sub-prime mortgages.

#### **Complements the Private Sector**

As discussed earlier, America is built on the concept that competition is healthy for the market. It improves efficiency and quality while offering more competitively-priced products to consumers. Making FHA more competitive will improve the services and products provided by other lenders and insurers in the industry. Consumers will be offered FHA programs that serve a similar purpose but are certainly not identical to conventional programs now available. This healthy level of competition should drive down the cost of programs that serve those with minimal down payments or who need flexible underwriting to obtain home financing.

Borrowers who can afford larger down payments or who have reasonable equity levels do not find the FHA program to be a reasonable alternative to conventional financing. Nearly all FHA borrowers have a loan-to-value ratio in excess of ninety percent. Since 1980, FHA has never served more than fifteen percent of the total housing market but, at times, it insured nearly fifty percent of urban mortgages. Clearly, this legislation will not make the FHA program a threat to the overall mortgage market. At most, H.R. 1852 will help to restore FHA loan product origination to levels of previous years.

Nevertheless, the possibility that FHA could supplant certain conventional loans does exist. Such a result is inevitable if FHA regains market share. However, the conventional loans most likely to be supplanted are those made to borrowers who fall just short of receiving A-grade conventional loans. Many first-time, minority and low to moderate-income homebuyers find themselves in this situation but are forced to turn to the sub-prime market to achieve homeownership. This legislation makes FHA loan products a viable alternative for these prospective borrowers.

#### **FHA Utilization of Mortgage Brokers**

CAMB supports the proposed reforms to the FHA program outlined in H.R. 1852, but believes that the FHA program must first be a viable option for prospective borrowers. Regardless of how beneficial a loan product may be, it requires an effective distribution channel to deliver it to the marketplace. Unfortunately, many prospective borrowers are denied the benefits offered by the FHA program because mortgage brokers—the

most widely used distribution channel in the mortgage industry—are limited in offering FHA loan products.

According to Wholesale Access, mortgage brokers originated 38.6 percent of all FHA loans for a total of \$110 billion in 2003. Mortgage brokers want to further increase origination of FHA loan products for first-time, minority and low to moderate-income homebuyers. However, current financial audit and net worth requirements create a formidable barrier to mortgage broker participation in the FHA program. This barrier makes it difficult for mortgage brokers to offer FHA loan products to those borrowers that could clearly benefit by participating in the FHA program.

CAMB supports increased access to FHA loans so that prospective borrowers who may have blemished or almost non-existent credit histories, or who can afford only minimal down payments, have increased choice of affordable loan products and are not forced by default to the sub-prime loan market. In this spirit, CAMB believes the audit and net worth requirements should be eliminated for mortgage brokers that want to offer FHA loan products to consumers.

First, current FHA requirements impose cost prohibitive and time consuming annual audit and net worth requirements on mortgage brokers that want to originate FHA loans. These requirements place serious impediments in the origination process that functionally bar mortgage brokers from distributing FHA loans to the marketplace, leaving sub-prime loan products as the only other option for many borrowers.

Most small businesses find the cost to produce audited financial statements a significant burden. An audit must meet government accounting standards and only a small percentage of certified public accountants ("CPAs") are qualified to do these audits. Moreover, because many auditors do not find it feasible to audit such small entities to government standards, even qualified CPA firms are reluctant to audit mortgage brokers. Cost is not the only factor. A mortgage broker can also lose valuable time—up to several weeks—preparing for and assisting in the audit. Between the cost of hiring an accountant who meets government auditing standards and is willing to conduct the audit and the hours needed to compile and report the needed data, it is simply impractical for a small business to conduct this type of financial audit.

The net worth requirement for mortgage brokers is also limited to liquid assets because equipment and fixtures depreciate rapidly and loans to officers and goodwill are not permitted assets. To compound this, a broker who greatly exceeds the net worth requirement is forced to keep cash or equivalents of 20% of net worth up to \$100,000. There has been no evidence presented by FHA that loans originated by high net worth originators perform better than those with a lower net worth.

Moreover, annual audit and net worth requirements are unnecessary. Originators are already governed by contract agreements with their respective FHA-approved lenders,

affording HUD adequate protection against loss. FHA-approved lenders already submit to audits, thereby ensuring that customers are protected and can seek relief from dishonest originators.

In sum, the audit and net worth requirements are prohibitively expensive for a large majority of mortgage brokers and as a direct result, many brokers have been left with little choice but to originate loans other than FHA. As a result, the audit and net worth requirements actually limit the utility and effectiveness of the FHA program and seriously restrict the range of choice available for prospective borrowers who can afford only a minimal down payment. At a minimum, CAMB believes annual bonding requirements offer a better way to ensure the safety and soundness of the FHA program than requiring originators to submit audited financial statements.

A stated objective of the FHA program is to increase origination of FHA loan products and expand homeownership opportunities for first-time, minority, and low to moderate-income families. CAMB believes the solution to increase FHA loan production is simple—allow more avenues, such as mortgage brokers, to offer FHA loan products directly to consumers. As stated previously, mortgage brokers originate the majority of all residential loans and therefore, would provide HUD with the most viable and efficient distribution channel to bring FHA loan products to the marketplace.

Congress must ensure that FHA insured loan programs continue to serve as a permanent backstop for all first-time homebuyer programs. For this reason, we believe that Congress should create the ability for FHA loan limits to be adjusted up to 100% of the median home price, thereby providing a logical loan limit that will benefit both the housing industry and the consumer. Tying the FHA loan limit to the median home price for an individual county, and letting it float with the housing market, allows the FHA loan limits to respond to changes in home prices instead of some esoteric number computed through a complicated formula. In this fashion, the FHA loan limit will reflect a true home market economy. Rather than restrict purchases of new homes through a legislatively mandated ceiling, the FHA loan limit can automatically adjust under current guidelines established for increasing the FHA loan limit on a county-by-county basis.

#### **Future of the FHA Program If Legislation is Enacted or Not Enacted**

The proposed changes outlined in H.R. 1852 are needed to the FHA program to meet its chartered mandate, which is to help the underserved and underprivileged obtain the dream of sustainable homeownership. PMI will dominate the low and zero down payment market with little competition among the few players in that industry. The sub-prime mortgage market will fulfill the needs of those unable to obtain PMI insurance. Foreclosure rates could escalate. Minority families and first-time homebuyers may be underserved or even shut out of the housing market entirely. It is possible that FHA will have a pool of loans too small to effectively manage risk. Ultimately, FHA could be

removed as a helping hand to those who need it the most. The ripple effect of negative consequences could easily extend to the homebuilding industry and to the general economy as well.

On the other hand, Congress has the opportunity to revitalize the FHA program with this legislation. Borrowers will receive better loan programs at lower interest rates. We strongly urge this committee to support H.R. 1852.

**Conclusion**

CAMB appreciates the opportunity to offer our views on the FHA program and the legislation before us, H.R. 1852. I am happy to answer any questions.



WRITTEN STATEMENT

FOR THE RECORD

HOUSE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITIES

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

**THE EXPANDING AMERICAN HOMEOWNERSHIP ACT OF 2007:**

**H.R. 1852 AND RELATED FHA MODERNIZATION ISSUES**

APRIL 19, 2007

For additional information, please contact:  
Susanna Montezemolo  
AARP Federal Affairs Dept.  
202.434.3800

AARP appreciates this opportunity to offer a written statement for the record on the reverse mortgage provisions of H.R. 1852, the “Expanding Homeownership Act of 2007.” While the Association supports the provision that would remove the cap on the number of loans that can be insured under the Federal Housing Administration’s (FHA) Home Equity Conversion Mortgage (HECM) insurance program, we must regretfully oppose Section 18 because it would have the effect of increasing the already exorbitantly high origination fee cap for reverse mortgage borrowers. AARP also opposes the provision to study the feasibility of using reverse mortgages to purchase long-term care insurance. AARP strongly urges this Subcommittee to add language to the bill that would reduce the caps on origination fees as one important step in reducing the unacceptably high costs of these loans. We also urge the Subcommittee to repeal the current statutory authority to forgive the upfront mortgage insurance premium for HECM loans used to purchase long-term care insurance.

### **The High Costs of Reverse Mortgages**

Reverse mortgages can be an important financial tool for older homeowners, allowing them to tap their equity to pay off debts, address health or long-term care needs, or supplement their incomes. Although the number of borrowers is still relatively small, the volume of loans has increased substantially in recent years—quadrupling from 18,000 loans in FY 2003 to more than 75,000 loans in FY 2006.

Despite this increase in volume, the costs of reverse mortgages remain very high—indeed, much higher than for other mortgage products. The high cost of reverse mortgages is a major barrier to further growth in the volume of these loans. A national random sample telephone survey of homeowners counseled in HUD’s federally-insured reverse mortgage program was conducted in December of 2006 on behalf of the AARP Foundation and the Public Policy Institute. The survey found that

- for homeowners who decided against taking out a reverse mortgage, nearly two-thirds said that high costs were a reason for their decision;
- for homeowners who did take out a reverse mortgage, seven out of ten said that the costs were high.

As Appendix I of this statement documents, the fees associated with the “average” reverse mortgage can exceed \$25,000 over the lifetime of the borrower—without counting any interest charges. Again, those are the fees a borrower must pay in order to take out any loan proceeds to meet their needs. For younger borrowers and those with higher home values the transaction costs can be much higher still.

Many factors contribute to the high cost of reverse mortgages. Some factors are related to the nature of the loans; loans start with low balances because the mortgage insurance premium (MIP) charged by HUD includes a large up-front fee in addition to an interest add-on that is more typical for forward mortgages. The low volume and start up costs associated with the early years of the program have also contributed to high per loan costs. Finally, unknown risks

associated with a relatively new type of loan have also contributed to high interest rates and MIP fees.

Fortunately, in the past year, increasing volume and greater market certainty related to experience with HECMs has led to the first real competition in interest rates. New products have emerged to compete with HECMs, some with lower origination fees. The provision in H.R. 1825 removing the cap on the number of HECM loans is an important step in allowing the reverse mortgage industry to further develop in ways that could benefit consumers. In particular, removing the cap is essential to promote the future growth and competition necessary to reduce the current high costs of these loans.

### **The Impact of a Single National Limit on Reverse Mortgage Costs**

Section 18 of H.R. 1825 also includes a provision that would replace county-specific home value limits for FHA-insured reverse mortgages with a single national limit. A national limit could simplify the program and allow homeowners with high value homes to tap more of their equity. However, in the absence of language to lower origination fees, this provision would also increase the already exorbitant fees paid by reverse mortgage borrowers. AARP believes that this would make the loans too costly for consumers and therefore opposes this provision, unless Congress or regulators first lower the origination fee.

Since the beginning of the program, FHA has set the limits that originators can charge for HECM loans. Originally, FHA limited the amount of the origination fee that could be financed to a flat \$1,800, which effectively limited the fee charged by most originators. Ten years ago, FHA changed its method for calculating the limit on origination fees—setting a limit of two percent of the maximum claim amount, which is the lesser of the home’s value or the local 203(b) limit on FHA-insured forward mortgages. FHA took this step to mirror the prevailing method of charging origination fees for non-FHA insured reverse mortgages and to encourage more lenders to offer HECM loans.

In the ten years since this change was made, increasing home values and 203(b) limits have dramatically increased the origination fees charged to consumers. For example, the effective limit on origination fees for the highest valued homes more than quadrupled – from \$1,800 in 1996 to \$7,255 in 2006. In the absence of language to change the way that origination fees are calculated, the provision in Section 18 to establish a single national limit at the conforming loan limit would further increase the maximum fee to \$8,340.

Such fees are not justified by lender costs in originating loans and are out of line with the way fees are charged by forward mortgage lenders and by non-FHA reverse mortgage lenders. For example, origination fees on FHA-insured forward mortgages are limited to one percent of the loan amount. Expressed as a percentage of the loan amounts on comparably valued homes, the origination fees for HECMs are 2.3 to 3.9 times higher (see Appendix II for a comparison of origination fees charged for reverse and forward mortgages). Moreover, the leading non-FHA reverse mortgage originator now charges two percent of the *loan amount* rather than two percent of the *home value* for origination fees.

In order to bring the costs down to consumers and to align the charges with those made in the forward mortgage market and in the non-FHA reverse mortgage market, AARP strongly urges that the Subcommittee include statutory language in H.R. 1825 directing the HUD Secretary to lower origination fees and limit them to a percentage of the total loan amount available at closing. Even this limit would likely be substantially higher than the fees charged in the forward mortgage market, because reverse mortgage borrowers do not typically borrow the full amount available at closing. This approach to limiting fees would reduce costs for most borrowers, and it would still provide more than adequate compensation to loan originators.

If the origination fees were lowered, AARP would support a single national limit on the maximum claim amount for HECM loans. The Association opposes such a single national limit in the absence of effective measures to limit fees since adopting a higher national limit would only increase the maximum origination fee cap under the current method of setting that cap.

#### **Using HECMs to Purchase Long-Term Care Insurance**

Section 18 also includes a provision directing the HUD Secretary to conduct a study of the feasibility of forgiving the mortgage insurance premiums on HECMs used to pay for long-term care insurance. Such uses have already been thoroughly studied by HUD and, put simply, they are a bad idea. Rather than conducting further study, AARP strongly recommends that the Subcommittee repeal the existing statutory authority that could create federal incentives for bad economic decisions by consumers and consider testing ways to reduce the high costs of reverse mortgages for those with long-term care needs.

Section 201 of the American Homeownership and Economic Opportunity Act of 2000 provided for the waiver of upfront mortgage insurance premiums for Home Equity Conversion Mortgages (HECMs) used to fund long term care insurance (LTCI). AARP believes this provision is fundamentally flawed and that its implementation would be harmful to consumers, the reverse mortgage industry, and HUD's Home Equity Conversion Mortgage (HECM) program. Fortunately, HUD has never implemented this provision because it would:

#### A) Harm Consumers by

- 1) adding significant but easily misunderstood and undisclosed costs to the price of LTCI,
- 2) inducing consumers to purchase LTCI at a combined "policy + loan" cost that they cannot afford and may not need, and
- 3) inducing consumers to purchase LTCI in a way that may do them more harm than good;

#### B) hurt the reverse mortgage industry by

- 1) engendering negative reactions from consumers,
- 2) requiring administrative costs disproportionate to benefits,

- 3) potentially generating new types of loan defaults and rescissions; and
- C) hurt the HECM program by
- 1) undermining consumer and industry confidence in the program,
  - 2) effectively requiring HUD to become a LTCI regulator, and
  - 3) presenting actuarial risks to the HECM insurance fund and limit HUD's capacity to make more desirable program improvements.

This provision has already been thoroughly studied in a HUD-commissioned actuarial study. In addition, HUD issued an Advanced Notice of Proposed Rulemaking in 2004, which called for public comment on issues related to implementing Section 201. AARP's comments are included below as Appendix III. As that analysis shows, a 62-year-old couple using a reverse mortgage could add 67 percent to the cost of purchasing long-term care insurance in the early years even with forgiveness of the upfront mortgage insurance premium. This is because the couple pays all the costs associated with the reverse mortgage plus the premiums and cost-sharing associated with the long-term care insurance policy. By the time they reached their mid-70s, the cost of the mortgage would exceed the cost of the insurance and by the time they reached their 90's, the cost of the mortgage would be more than four times the cost of the insurance.

If older homeowners are unable to pay the cost of long-term care insurance, they are very unlikely to need such insurance for income and asset protection. Indeed, using reverse mortgages in this way runs the risk that older homeowners could exhaust the equity in their homes, no longer be able to pay the insurance premiums, and be forced to terminate their policies just when they are most likely to need them. So, older homeowners could end up with no insurance and no home equity to deal with long-term care needs when they arise.

AARP would support a demonstration to reduce the cost of reverse mortgages for those who have long-term care needs, such as individuals with significant levels of disability, and choose to tap their equity to pay directly for services and supports needed to address those disabilities. However, the Association opposes inducements to use reverse mortgages to purchase long-term care insurance. We recommend that the Subcommittee repeal Section 201 of the American Homeownership and Economic Opportunity Act of 2000 rather than further study its feasibility and test ways to reduce the high costs of reverse mortgages for those with long-term care needs.

AARP has appreciated the strong cooperation with this Subcommittee over the years in adapting the HECM program to changing market conditions and in providing high quality information to consumers. Although we support the provisions to increase the volume of loans, we must strongly oppose the reverse mortgage section of the bill because it would increase costs to consumers and potentially promote inducements to make bad decisions regarding the use of reverse mortgages to purchase of long-term care insurance. We look forward to working with the Subcommittee to further improve the program at this critical juncture in the development of the reverse mortgage industry.

### Appendix I: The Total Cost of Federally-Insured Reverse Mortgages

This appendix analyzes the total cost of federally-insured Home Equity Conversion Mortgages (HECMs). It first looks at the costs for a base case - a borrower of average age living in a home of average value in the HECM program. Then it compares the total cost of this loan to an average HECM borrower's income, and to the loan amount. Next, the analysis shows in which circumstances the total cost can be greater than the base case example. Finally the analysis concludes by noting that the total cost of a HECM loan can in some cases exceed the "high-cost" loan definition in the Home Ownership and Equity Protection Act (HOEPA).

- A) **Fees Can be \$25,000 for Borrower of Average Age and Home Value** - The non-interest costs of a HECM loan for a borrower of average age (74) living in a home of average value (\$255,000) can be about \$25,000, assuming the borrower lives to the remaining life expectancy (12 years) prescribed by federal Truth-in-Lending disclosures for HECM loans. Table 1 itemizes the fees, all of which are charged to the loan at closing except for the monthly servicing fee and monthly mortgage insurance premium.

**Table 1: Total HECM Fees until Life Expectancy for a 74-year-old Borrower in a \$255,000 Home\***

Loan Fee	HUD Limit or Specification	Amount
Origination Fee	Limited to 2% of home value or 2% of HUD's county equity limit, whichever is less	\$5,100
Upfront Mortgage Insurance Premium (MIP)	Equals 2% of home value or 2% of HUD's county equity limit, whichever is less	\$5,100
Third-Party Closing Costs	Limited to "customary & reasonable"	\$2,200**
Monthly Servicing Fees	Limited to \$35 per month	\$5,040***
Monthly MIP	Equals 0.04167% of loan balance each month	\$8,014***
<b>TOTAL FEES =</b>		<b>\$25,454</b>

\* The average HECM borrower in FY 2005 was 73.8 years old and lived in a home worth \$254,900

\*\* Hypothecated national average; actual figures range from less than \$2,000 to more than \$6,000

\*\*\* Assuming borrower lives to the remaining median life expectancy (12 years) for a 74-year-old and withdraws 50% of the available loan amount at closing, which is the creditline usage pattern prescribed by Truth-in-Lending law for HECM disclosures. In this loan, the amount withdrawn from the HECM creditline at closing is \$71,115, which is 50% of the available creditline amount. The assumed interest rate is the one that was in effect on 5/10/06, which was 6.48%. For additional information see the Methodological Note on page 4.

- B) **HECM Fees Can Exceed Borrower Income** - The fees - not counting interest - for the HECM borrower in Table 1 were \$25,454. This amount is greater than the average

annual income of HECM borrowers, which was \$18,240 in FY 2004 (Source: HUD Policy Development and Research).

C) **Total Costs Exceed Loan Amount** – Table 2 shows all the costs on the HECM loan from Table 1. The “Loan Fees” column shows that the fees of \$25,454 from Table 1, when added to the loan balance, generate \$20,552 in interest charges over the 12 years of the 74-year-old borrower’s remaining life expectancy. The “Loan Advances” column shows that a creditline cash advance of \$71,115 to the borrower at closing generates another \$83,325 in interest charges. So at the end of the loan, the homeowner has borrowed \$71,115, but now also owes \$25,454 in loan fees plus \$103,877 in total interest charges for a total cost of \$129,331 – which is 182% of the loan amount (\$71,115). The loan balance (amount owed) at this time is \$200,446.

**Table 2: Total HECM Fees, Interest, and Loan Advances until Life Expectancy for a 74-year-old Borrower in a \$255,000 Home\***

	<b>Loan Fees</b>	<b>Loan Advances</b>	<b>TOTAL</b>
<b>Principal</b>	\$25,454	\$71,115	\$96,569
<b>Interest</b>	\$20,552	\$83,325	\$103,877
<b>TOTAL =</b>	\$46,006	\$154,440	\$200,446

\* See table 1 for details about this loan.

D) **Total Costs Can Be Greater** – HECM costs depend on a variety of factors. Table 3 illustrates the impact of three key variables, showing that the costs for the loan in Tables 1 and 2 would be greater if:

- the home value is higher;
- the home is located in a state with larger third-party closing costs; and
- the borrower is younger.

Table 3 shows the total costs for

- the largest home value that the HECM program can use to determine available loan amounts (\$362,790);
- in the areas with the largest third-party closing costs (Broward, Collier, Palm Beach, and Miami-Dade counties in Florida);
- for the youngest eligible HECM borrower (age 62).

**Table 3: HECM Loan Costs for a 62-Year-Old Borrower Living in a \$362,790 Home in Four Counties in Florida\***

<b>Loan Cost</b>	<b>Amount</b>
Origination Fee	\$7,256
Upfront Mortgage Insurance Premium (MIP)	\$7,256
Third-Party Closing Costs*	\$6,657
Monthly Servicing Fees**	\$8,400
Monthly MIP**	\$21,844
<b>TOTAL FEES =</b>	<b>\$51,413</b>
<b>TOTAL INTEREST =</b>	<b>283,110</b>
<b>TOTAL COSTS =</b>	<b>\$334,523</b>
<b>Loan Advance Amount =</b>	<b>\$76,446</b>
<b>Total Amount Owed =</b>	<b>\$410,969</b>

\*Actual third-party closing costs on a \$362,790 home in Broward, Collier, Palm Beach, and Miami-Dade counties in Florida, according to a major national HECM lender

\*\* Assuming borrower lives to the remaining median life expectancy (20 years for a 62-year-old) and follows the creditline usage pattern prescribed by federal Truth-in-Lending law for HECM disclosures, 50% at closing (\$76,446) and none thereafter. See notes to Table 1 for additional explanation.

E) **HECM Costs Can Exceed “High-Cost” Lending Limits** - The upfront fees on a HECM can exceed the federal government’s definition of “high-cost” mortgages. As defined by the Home Ownership and Equity Protection Act (HOEPA), a forward mortgage is deemed "high-cost" if its total loan fees payable at closing exceed 8 percent of the loan amount. The upfront costs payable at closing on a HECM do in some cases exceed 8% of the loan amount.

(When HOEPA was enacted in 1994, it exempted reverse mortgages from the high-cost definition because the Act’s restrictions on such mortgages, if applied to reverse mortgages, would have prohibited reverse mortgages. Instead, HOEPA subjected all reverse mortgages to a specialized new “Total Annual Loan Cost” disclosure. The TALC disclosure presents the annual average cost of the loan expressed as a single rate at three home appreciation rates [0%, 4%, and 8%], and three loan terms [2 years, life expectancy, and 140% of life expectancy].)

**Methodological Note:** The total of ongoing costs actually paid on the loans presented in Tables 1-3 would differ from the amounts estimated for the following reasons:

- The tables assume that the initial interest rate never changes over the life of the loan. But the interest on HECM loans is adjustable. So if the actual rate decreases, then ongoing interest and mortgage insurance premium (MIP) costs would be less, and if the actual rate increases, then ongoing interest and MIP costs would be more.
- The tables assume that the loans end when the borrowers reach their remaining median life expectancy. But some borrowers will remain in their homes longer than that, and others will leave or die sooner. The total costs for longer-lived borrowers would be greater than the estimated amounts, and the total costs for those who leave or die sooner would be less.
- The tables assume that creditline borrowers withdraw 50% of their available loan funds at closing and none thereafter, which is the withdrawal pattern prescribed for HECM disclosures by federal Truth-in-Lending law (as explained in the footnotes to Table 1). In reality, HUD research has found that creditline borrowers have withdrawn their available funds at a substantially earlier and greater rate. Since the amount of funds remaining available in a HECM creditline grows larger every month, this more aggressive actual withdrawal pattern would result in larger loan balances and, therefore, greater charges for interest and monthly mortgage insurance premiums.

**Comparison of Total HECM Loan Costs  
until Life Expectancy for Three Borrowers**

<b>Borrower</b>	<b>A</b>	<b>B</b>	<b>C</b>
<b>Age of Borrower*</b>	<b>74</b>	<b>74</b>	<b>62</b>
<b>Home Value*</b>	<b>\$255,000</b>	<b>\$362,790</b>	<b>\$362,790</b>
<b>Home Location**</b>	<b>USA</b>	<b>California</b>	<b>Florida</b>
<b>FEES</b>			
Origination Fee	\$5,100	\$7,256	\$7,256
Upfront Mortgage Insurance	\$5,100	\$7,256	\$7,256
Third-Party Closing Costs***	\$2,200	\$2,387	\$6,657
<b>Ongoing Fees</b>			
Monthly Servicing Fees****	\$5,040	\$5,040	\$8,400
Monthly MIP****	\$8,014	\$11,378	\$21,844
<b>TOTAL FEES</b>	<b>\$25,454</b>	<b>\$33,317</b>	<b>\$51,413</b>
<b>TOTAL INTEREST****</b>	<b>\$103,877</b>	<b>147,466</b>	<b>283,110</b>
<b>TOTAL LOAN COSTS</b>	<b>\$129,331</b>	<b>\$180,783</b>	<b>\$334,523</b>
<b>Loan Advance Amount</b>	<b>\$71,115</b>	<b>\$102,610</b>	<b>\$76,446</b>
<b>Total Amount Owed</b>	<b>\$200,446</b>	<b>\$283,392</b>	<b>\$410,969</b>

\*The average HECM borrower in FY 2005 was 73.8 years old and lived in a home worth \$254,900

\*\*The "USA" example (Borrower A) is the loan in Tables 1 and 2; the Florida example (Borrower C) is the loan in Table 3. The specific locations for borrowers B and C are Alameda County, CA and Miami-Dade County, FL, respectively.

\*\*\*The figure for Borrower A (\$2200) is a hypothecated national average; other figures are estimates provided by a major national HECM lender.

\*\*\*\* Assuming borrower lives to the remaining median life expectancy (12 years for a 74-year-old; 20 years for a 62-year-old) and withdraws 50% of the available loan amount at closing, which is the creditline usage pattern prescribed by Truth-in-Lending law for HECM disclosures. In these loans, the amount withdrawn from the HECM creditline at closing is the figure listed as the "Loan Advance Amount," which is 50% of the available creditline amount. The assumed interest rate is the one that was in effect on 5/10/06, which was 6.48%. For additional information see the Methodological Note on the previous page.

**Appendix II: Analyzing the HECM Origination Fee Limit**

- 1) The FHA's origination fee limit on HECM loans is from 2.3 to 3.9 times greater than the comparable limit on its "forward" mortgages.
- 2) The FHA calculates its origination fee limit in one way for HECMs and in another way for forward mortgages.
- 3) The HECM origination fee limit - if expressed in the same way as for forward mortgages - would range from 2.3% to 3.9% of the loan amount.
- 4) The HECM origination fee can exceed 10% or more of the loan amount for borrowers who do not receive all of their available loan funds.
- 5) The HECM origination fee limit is confusing and can be misleading.
- 6) The maximum HECM origination fee limit has increased by 303% over the past ten years, and is likely to rise by 51% in about two years if a single national HECM home value limit is approved by Congress.
- 7) The HECM origination fee limit is greater than the same limit on most private sector reverse mortgages currently being closed in the U. S.
- 8) High costs are the most common negative comment about HECMs by consumers who consider them.
- 9) While there may be justification for somewhat greater origination fees on HECMs than on forward mortgages,
  - a) it is highly unlikely that the unit cost of originating a HECM is from 2.3 to 3.9 times greater than it is for a forward mortgage - or 10 or more times greater for HECM borrowers who do not receive all of their loan funds
  - b) it is highly unlikely that the unit cost of originating a HECM has grown by 303% over the past ten years, or by 51% in about the past two years
  - c) HECM origination fees should be reduced because of a) and b) above, and so that HECM can remain competitive with the private sector, which now has lower origination fees when providing larger loan amounts.
  - d) a reduced HECM origination fee limit should be based on the borrower's loan amount (not the home value) because it's less confusing and misleading, and it conforms to the origination fee calculation method on FHA's forward mortgages and most private sector reverse mortgages currently being closed in the U. S.

- 1) **HECM Limit Is Much Greater than “Forward” Mortgage Limit** - The FHA’s origination fee limit on HECMs is from 2.3 to 3.9 times greater than the comparable limit on its “forward” mortgages, based on the same loan amount (see Table 1).

On a fairly typical home value in the HECM program (\$250,000), the HECM origination fee limit exceeds the FHA forward mortgage limit by from \$2,819 to \$3,730, depending on the age of the HECM borrower. On a home valued at the top 203-b limit in the continental U. S. (\$362,790), the HECM limit exceeds the forward mortgage limit by from \$4,089 to \$5,413.

**Table 1: FHA Origination Fee Limits on HECMs v. “Forward” Mortgages**

HECM Borrower			FHA Origination Fee Limit		Difference****	
Home Value*	Age	HECM Loan Amount**	HECM	FHA-Insured*** “Forward” Mortgage	\$	X
<b>\$250,000</b>	62	\$127,000	\$5,000	\$1,270	<b>\$3,730</b>	<b>X 3.9</b>
	75	\$162,000	\$5,000	\$1,620	<b>\$3,380</b>	<b>X 3.1</b>
	95	\$218,250	\$5,000	\$2,182	<b>\$2,819</b>	<b>X 2.3</b>
<b>\$362,790</b>	62	\$184,297	\$7,256	\$1,843	<b>\$5,413</b>	<b>X 3.9</b>
	75	\$235,088	\$7,256	\$2,351	<b>\$4,905</b>	<b>X 3.1</b>
	95	\$316,716	\$7,256	\$3,167	<b>\$4,089</b>	<b>X 2.3</b>

\* Assuming home value is less than or equal to the 203-b home value limit.

\*\* HECM principal limit assuming expected rate = 6.5%.

\*\*\* Limit equals 1% of loan amount (<http://www.hud.gov/offices/hsg/sfh/ins/203b--df.cfm>)

\*\*\*\* The origination fee limit on HECMs exceeds the origination fee limit on FHA-insured forward mortgages by the dollar figures displayed in the “\$” column. The “X” column shows how many times greater the HECM limit is than the limit on forward mortgages. For example, for a 62-year-old borrower, the HECM origination fee limit is 3.9 times greater than the limit on an FHA-insured forward mortgage of the same loan amount.

- 2) **Calculation Methods Differ** - The reason that FHA's origination fee limits are so much greater on HECMs than on its forward mortgages is that they are calculated in a different way. The HECM limit equals **2% of the home's value** or the 203-b limit, whichever is less, with a minimum charge of \$2,000. But the origination fee limit on FHA-insured forward mortgages is **1% of the loan amount** (see Table 2).

**Table 2: Calculating FHA Origination Fee Limits**

	<b>HECM</b>	<b>FHA-Insured "Forward" Mortgage</b>
<b>Origination Fee Limit Equals . . .</b>	<b>2% of home value or 203-b limit, whichever is less (or \$2,000 if it is greater)</b>	<b>1% of loan amount</b>

- 3) **HECM Limit = 2.3% to 3.9% of Loan Amount** - If HECM origination fee limits were expressed as a percent of the loan amount, they would range from 2.3% to 3.9%, as shown in Table 3.

**Table 3: Origination Fee Limits  
as a Per Cent of Loan Amount**

<b>HECM Borrower</b>			<b>HECM Origination Fee Limit</b>		<b>FHA-Insured Forward Mortgage Origination Fee Limit as a % of Loan Amount***</b>
<b>Home Value*</b>	<b>Age</b>	<b>HECM Loan Amount**</b>	<b>= 2% of Home Value</b>	<b>As a % of Loan Amount</b>	
<b>\$250,000</b>	62	\$127,000	\$5,000	<b>3.9%****</b>	<b>1.0%</b>
	75	\$162,000	\$5,000	<b>3.1%****</b>	<b>1.0%</b>
	95	\$218,250	\$5,000	<b>2.3%****</b>	<b>1.0%</b>
<b>\$362,790</b>	62	\$184,297	\$7,256	<b>3.9%****</b>	<b>1.0%</b>
	75	\$235,088	\$7,256	<b>3.1%****</b>	<b>1.0%</b>
	95	\$316,716	\$7,256	<b>2.3%****</b>	<b>1.0%</b>

\* Assuming home value is less than or equal to the 203-b home value limit.

\*\* HECM principal limit assuming expected rate = 6.5%.

\*\*\* Limit equals 1% of loan amount (<http://www.hud.gov/offices/hsg/sfh/ins/203b--df.cfm>)

\*\*\*\* All percents are minimums, as explained in 4) on next page.

**4) Fees Even Greater For Many HECM Borrowers** - In a forward mortgage, the borrower typically receives the full loan amount at closing. But in a reverse mortgage, most borrowers do not receive the full loan amount at closing, and many do not ever receive the full loan amount. Most borrowers prefer to defer their receipt of some or most of their available loan funds until a future time. For example,

- If a HECM borrower takes 25% of the full loan amount at closing and then the loan ends (due to borrower death or sale of the home) before additional funds are taken, the origination fee expressed as a percent of the loan amount would be **four times** the percents displayed in **Table 3**. So they would equal **15.6%, 12.4%, and 9.2%** depending on the age of the borrower.
- If the borrower received 50% of the full loan amount - the assumption required by Truth-in-Lending for specialized reverse mortgage cost disclosures - then the origination fee expressed as a percent of the loan amount would be **double** the percents in **Table 3**, ranging from **7.8% to 4.6%**.

**Table 4** displays this information. But it does not show what would happen in less typical cases when, for example, a HECM borrower might receive, say, 10% of the loan amount. Although an atypical occurrence, a borrower could receive such a small percent of the loan amount, in which case the origination fee expressed as a percent of the loan amount received would be **ten times** the percents in **Table 3**, ranging from **23% to 39%**.

**Table 4: HECM Origination Fees as a Per Cent of Loan Amount When Borrower Receives Less Than 100% of Loan Amount**

HECM Borrower			HECM Origination Fee Limit		HECM Origination Fee as a % of Loan Amount When Borrower Receives	
Home Value*	Age	HECM Loan Amount**	= 2% of Home Value	As a % of Loan Amount	25% of Loan Amount	50% of Loan Amount
<b>\$250,000</b>	62	\$127,000	\$5,000	3.9%	15.6%	7.8%
	75	\$162,000	\$5,000	3.1%	12.4%	6.2%
	95	\$218,250	\$5,000	2.3%	9.2%	4.6%
<b>\$362,790</b>	62	\$184,297	\$7,256	3.9%	15.6%	7.8%
	75	\$235,088	\$7,256	3.1%	12.4%	6.2%
	95	\$316,716	\$7,256	2.3%	9.2%	4.6%

\* Assuming home value is less than or equal to the 203-b home value limit.

\*\* HECM principal limit assuming expected rate = 6.5%.

- 5) HECM Limit is Confusing and Misleading** - Expressing the HECM origination fee limit as a percent of the home value (or 203-b limit, if it is less - or \$2,000 if it is more than either 2% of the home value or 2 % of the 203-b limit) is confusing - and can be misleading.

The best evidence that some consumers are confused and may be misled by this convoluted formula for limiting the origination fee is that one of the nation's preeminent personal finance columnists - Jane Bryant Quinn of Newsweek - was confused by it and inadvertently misled readers by stating that the limit was 2% of the loan amount. In the May 1, 2006 edition of Newsweek she corrected the error at the end of a subsequent column as follows:

In my recent story, What Will You Do When Your Paycheck Stops, I understated the high cost of reverse mortgages. The lender can charge up to 2 percent of the value of your house, not the value of your loan.

Publishing a correction in her column is a rare occurrence for Ms. Quinn, as any review of her columns would confirm. So making an error in this case clearly implies that many consumers - far less familiar with housing finance in general and reverse mortgages in particular than Ms. Quinn - are likely to make the same mistake that she did. They may do so because "2% of loan amount" seems more likely, because it's what they would expect, or because the formula is so complicate and that's what they hear.

Many consumers are undoubtedly making the same mistake, either because it's "only" 2%, which may not sound like much, or because they just assume it must be "usual and customary."

- 6) Significant Increases in HECM Origination Fee Limit** - The maximum HECM origination fee limit has increased by **303%** over the past ten years, and will increase by **51%** in about two years if Congress approves a single national home value limit for the HECM program.

**Table 5** shows how the maximum HECM origination fee in the continental U. S. has increased on an annual basis since 1996, when the limit was a flat \$1,800. In 1997, the limit was raised to 2% of the home value or 203-b limit, whichever is less, or a minimum of \$2,000. Beginning in 1997, the table displays the maximum 203-b limit in the continental U. S. and shows the corresponding maximum origination fee, which equals 2% of the maximum 203-b limit.

**Table 5** also shows the percentage increase in the maximum origination fee on an annual and cumulative basis. In the ten years since 1996, the maximum fee has increased by 303%. If Congress approves a single national home value limit in the HECM program at the conforming loan limit (currently \$417,000) and it increases by only 5% from 2006 to 2007, the maximum origination fee would increase by 51% in the two years between 12/31/04 and 1/1/2007.

Table 5: HECM Origination Fee Limits - 1996 to 2006

Year	Maximum HECM		Percent Change	
	203-b Limit*	Origination Fee	Per Year	Since 1996
1996		\$1,800**		
1997	\$160,950	\$3,219	78.8%	79%
1998	\$197,621	\$3,952	22.8%	120%
1999	\$208,800	\$4,176	5.7%	132%
2000	\$219,849	\$4,397	5.3%	144%
2001	\$239,250	\$4,785	8.8%	166%
2002	\$261,609	\$5,232	9.3%	191%
2003	\$280,749	\$5,615	7.3%	212%
2004	\$290,319	\$5,806	3.4%	223%
2005	\$312,896	\$6,258	7.8%	248%
2006	<b>\$362,790</b>	<b>\$7,256</b>	<b>15.9%</b>	<b>303%</b>
2006	\$417,000***	\$8,340	33.3%	363%
2007	\$437,850****	\$8,757	20.1%	387%

\* In continental U. S. \*\* Maximum was a flat \$1,800 in 1996

\*\*\* If Congress enacts a single national home value limit for the HECM program

\*\*\*\* Projecting a 5% increase in the maximum 203-b limit for 2007

- 7) **HECM Fee Exceeds Private Sector Fee** - Until recently the HECM program accounted for the vast majority of reverse mortgages closed in the U. S. It did so because for most borrowers it provided significantly larger loan amounts at significantly lower costs.

But in July of 2006, the only major private sector competitor to the HECM program increased its reverse mortgage loan amounts radically and reduced its origination fee. As a result, for the first time, a private sector reverse mortgage now charges a lower origination fee than HECM for borrowers who get similar to smaller loan amounts from HECM. In addition, for such borrowers, the total cost of the private sector plan is now less costly than HECM throughout the earlier years of the loan.

The private sector competitor is the "Cash Account" reverse mortgage from Financial Freedom Senior Funding Corporation, which is also the leading originator and servicer of HECM loans. Cash Account provides larger loan amounts than HECM on higher-valued homes. Generally, a home must be worth about \$460,000 or more before Cash Account provides a similar or larger initial loan amount.

**Table 6: HECM v. Cash Account Origination Fees**

At age	Maximum initial HECM loan amount when home value is \$362,790 or more	Home value needed to get a similar initial loan amount from Cash Account (single borrower)	Origination Fee		HECM Fee Exceeds Cash Account Fee by
			HECM = 2% of Claim Amount*	Cash Account = 2% of Loan Amount	
65	\$168,100	\$500,000	\$7,256	\$3,362	\$3,894
70	\$188,200	\$480,000	\$7,256	\$3,764	\$3,492
75	\$209,600	\$460,000	\$7,256	\$4,192	\$3,064
80	\$232,100	\$480,000	\$7,256	\$4,642	\$2,614
85	\$254,200	\$500,000	\$7,256	\$5,084	\$2,172

\* "Claim amount" equals home value or HUD 203-b limit, whichever is less.

**Table 6** displays the difference in origination fees between HECM and Cash Account when each loan provides a similar initial loan amount, based on the highest 203-b limit in the continental U. S., which is \$362,790. The HECM fee equals 2% of the home value or 203-b limit (whichever is less), and the Cash Account fee equals 2% of the loan amount.

The HECM origination fee exceeds the Cash Account fee by from \$2,172 to \$3,894, depending on the borrower's age. In addition, the Cash Account does not charge an explicit MIP - it just reduces its unstated implicit gross loan amount by its implicit "MIP" and provides the "net" loan amount figures to consumers. As a result, Cash Account charges much lower total upfront fees than HECM. On the other hand, Cash Account charges a higher interest rate, so its total costs tend to be greater during the middle and later years of the loan, as measured by the borrower's life expectancy.

In short, HECM no longer charges the lowest origination fee to the borrowers who get similar or greater initial loan amounts from its major competitor.

**8) High Costs Are Most Common HECM Problem for Consumers - The AARP Foundation's Reverse Mortgage Education Project** sends a client satisfaction survey to homeowners counseled by exam-qualified HECM counselors who are approved by HUD to offer HECM counseling by telephone on a national basis.

Each survey concludes with an open-ended question asking "Is there anything else you would like to tell us?" An informal analysis of these open-ended "verbatim" comments during 2005 found that about 60% of the negative comments entered by clients were about high loan costs. These included comments by clients who became reverse mortgage borrowers, who decided against a reverse mortgage at the present time, and who decided against a reverse mortgage. A sampling of these open-ended responses is provided below.

**A) Comments by clients who became reverse mortgage borrowers**

I hope I made the right decision!!! I was astounded to find closing COSTS so ridiculously HIGH. This should be investigated.
It was extremely EXPENSIVE. If the reverse mortgage was not an absolute necessity for me to remain in my home, I assure you, I most certainly would not have done it!
The closing COSTS are excessively HIGH. Elderly people with a modestly priced house will not feel comfortable paying so much.
The only difficulty was swallowing all those closing COSTS.
The costs are exorbitant and someone is taking advantage of those of us who really need access to the money. But we don't have much choice. I took a loan, but I would advise anyone to take a good hard look before making the choice.
Well pleased but EXPENSIVE loan costs.
The closing costs, which are exorbitant, should be reviewed.
We thought the reverse mortgage rather costly.
This is a very EXPENSIVE process.
The negative is the huge, up front cost. We decided to use the positive equity in our home, (rather) than sell stock which had dropped about 40% in the last three years.
The amount of money the representatives make in commission is much too HIGH.
My only negative feeling about this whole experience is the COST of placing the reverse mortgage - in my case \$11,683 for a principal of \$79,420.
Learned Reverse Mortgages extremely EXPENSIVE

**B) Comments by clients who decided against a reverse mortgage at this time**

Have delayed getting RM because of concern for the COSTS involved. Probably will proceed because of need.
The reverse mortgage could solve many problems for the elderly who own homes. For me the closing COSTS and monthly service COSTS seemed excessive.
The finance COSTS are tremendous - that has delayed me for 2 years. But now I have to bite the bullet? Still unsure whether to sell my tremendously appreciated house (which would mean cleaning out & organizing 50 years of accumulated everything), or get a reverse mortgage (and a breather)
I couldn't go along with reverse mortgage at this time. COST is quite high.
Because of the HIGH cost of a reverse mortgage decided to use that option as a last choice if necessary in the future.
A reverse mortgage loan is in my future. I do not like that it COSTS us very much to get the loan. It COSTS more than I need at this time, but I'll need it for living expenses.
May want to move in 1st 5years would make loan very EXPENSIVE. May wish to re-apply in 5-6 years.
It was more EXPENSIVE than I first thought, so decided it was not for me, at least not at this time.
The expense of setting (up) this Reverse Mortgage is so huge.

We're having trouble with the idea of the initial expense even though it can be financed.
Many people feel reverse mortgage are too expensive. So I am still undecided.

**C) Comments by clients who decided against a reverse mortgage**

My decision to not get a reverse mortgage was based on the high set-up fees.
They charge too much. Cost is too much in long run.
Reverse Mortgage is a good concept. However my family thought that the fees were too costly.
I didn't want to pay for that kind of interest and administration fees.
The daunting fee structure and interest rates and insurance fees were extreme and excessive. These factors helped to decide against rev-mortgage - not worth the trouble when most of the home value is "eaten" up by too many fees.
Reverse Mortgage are Very expensive! If you sell your house later to move to something smaller or more conveniently located, the reverse mortgage takes a large hunk of your equity.
Everyone benefited more financially than me.
The cost is too much to get this reverse mortgage.
Reverse mortgages sounded like an answer to my prayers and the answer to my financial situation. After counseling the price seemed too much to pay.
I feel rev. mortgages are very expensive. A very drastic step.
We felt in the long term it would cost more than we could ill afford.
At 82 years of age we both thought that the initial cost was too severe.
Closing cost are way too high, especially for a government sponsored program
A good program but too expensive.
Decided that it would cost too much for the reverse mortgage.
I found the expenses involved with a reverse mortgage unacceptable.
The "off the top" fees were too high.
To get a reverse mortgage COSTS much too much.
"Up front" charges of 10-11% are absolutely unreasonable. On a conventional mortgage the limited is considered 3% of amount to be financed. Reverse mortgage charges at least 10% are just too much to absorb unless one is desperate for the money.
I am appalled at the COSTS of acquiring a reverse mortgage. The lender commits usury.
The amount taken out of loan is obscene. You are paying interest on a large sum to start.
Good idea, but the cost of administration and setting up program (is) excessive.
Upfront COSTS are too HIGH.
Bottom line is that a reverse mortgage is very costly (\$28,000-\$30,000). Therefore I hesitated to obtain one and am giving thought to other alternatives
Reverse mortgages aren't as good as they sound. There are too many costs.

Too EXPENSIVE for me.
The closing cost are exorbitant. And if we had to sell within 2 or 3 years after the loan, the interest rate on the loan may well be over 100% APR. We think the lenders take advantage of us. We are very disappointed in Reverse Mortgages and the way the lenders take advantage of old people.
The cost of getting a reverse mortgage was HIGHER than the need for it for me.
It cost too much money to get this done.
Closing cost way too HIGH!
I was disappointed in the program. For "senior" seniors with limited life expectancy (5-7-9 yrs) the upfront fees/charges are prohibitive. Inheritors would lose greatly, and banks would earn greatly. Therefore, reverse mortgage was not a practical solution to the financial woes of this senior.
Closing fees of \$10,000 is an outrage against senior citizens. The program is designed to allow the lender a most unfair advantage. Would be used as a last resort, by me
Was too much for closing costs. Thanks but no thanks.
Reverse mortgages are EXPENSIVE and probably not for people who have a short life expectancy. You need your years of life to justify the high expenses. The whole system is set up to guarantee the bank or lender with profit and assume no risk.
I find it too EXPENSIVE for any needs at this time
Our decision not to do anything was based on the cost to us of using the reverse mortgage plan a little too EXPENSIVE for our thinking
Decided the COSTS outweighed the advantages
My reluctance is the upfront COSTS
I found that the closing COSTS were quit HIGH and discouraged me from continuing with the process
The finance cost for getting a reverse mortgage was too HIGH.
The up front cost was too HIGH for me.

**Appendix III: AARP Comments on waiver of the upfront mortgage insurance premium for HECMs used to fund long-term care insurance**

January 21, 2005

Regulations Division  
Office of General Counsel, Room 10276  
Department of Housing and Urban Development  
451 Seventh Street SW  
Washington DC 20410-0500

Re Docket No.FR-4857-A-01; HUD-2004-0016

AARP welcomes the opportunity to comment on HUD's Advance Notice of Proposed Rulemaking (ANPR) regarding Section 201 of the American Homeownership and Economic Opportunity Act of 2000. That section amended section 255 of the National Housing Act to provide for the waiver of upfront premiums for Home Equity Conversion Mortgages (HECMs) used to fund long term care insurance (LTCI).

*AARP believes this provision is fundamentally flawed and that its implementation would be harmful to consumers, the reverse mortgage industry, and HUD's Home Equity Conversion Mortgage (HECM) program.* Implementing this provision would be harmful to:

A) **Consumers** because it would

- 4) add significant but easily misunderstood and undisclosed costs to the price of LTCI,
- 5) induce consumers to purchase LTCI at a combined "policy + loan" cost that they cannot afford and may not need, and
- 6) induce consumers to purchase LTCI in a way that may do them more harm than good;

B) **The reverse mortgage industry** because it would

- 1) engender negative reactions from consumers,
- 2) require administrative costs disproportionate to benefits,
- 3) generate new types of loan defaults and rescissions; and

C) **The HECM program** because it would

- 1) undermine consumer and industry confidence in the program,

- 2) effectively require HUD to become a LTCI regulator, and
- 3) present actuarial risks to the HECM insurance fund and limit HUD’s capacity to make more desirable program improvements.

*As discussed in this commentary, the ill effects of Section 201 cannot be eliminated or ameliorated simply by addressing the questions posed in this ANPR. Accordingly, AARP urges HUD to recommend that the appropriate authorizing committees of Congress repeal these provisions.*

**A) HARMFUL TO CONSUMERS**

Implementation of Section 201 would be harmful to consumers because it would 1) add significant but easily misunderstood and undisclosed costs to the price of LTCI, 2) induce consumers to purchase LTCI at a combined “policy + loan” cost that they cannot afford and may not need, and 3) induce consumers to purchase LTCI in a way that may do them more harm than good;

**1) Increasing LTCI Costs:** The cost of LTCI purchased with a HECM loan includes the cost of the LTCI policy plus the cost of the HECM, which includes upfront costs and monthly servicing, interest, and mortgage insurance costs.

- o **Upfront Costs:** Even without the upfront mortgage insurance premium (MIP), the upfront costs on a HECM loan are substantial. They include a large origination fee and various third-party closing costs. The total typically depends on the value of the borrower’s home, as the following examples illustrate:

Home Value	Total Upfront Costs without Upfront MIP
\$100,000	<b>\$4,000</b>
\$150,000	<b>\$5,000</b>
\$200,000	<b>\$6,000</b>

- o **Monthly Costs:** HECM borrowers are also charged a servicing fee of \$35 per month, interest at the prevailing rate, and a periodic MIP that equals 0.0416 percent of the loan balance each month (0.5 percent annually). The total dollar amount of these monthly charges grows larger over time because the interest and MIP charges are based on a growing loan balance.

For example, a 62-year-old couple living in a \$200,000 home in December of 2004 could get a HECM creditline of \$109,610 at 4.16 percent interest if - as

Section 201 provides - no upfront MIP is charged. But then the interest rate would adjust every month based on future changes in the 1-year Treasury rate. To project future loan balances, the HECM program uses an “expected” rate based on the 10-year Treasury rate, which in this case would be 5.66 percent. So the rate actually charged on this loan would be likely to fall within a range of 4.16 to 5.66 percent. (This loan has no annual interest rate cap, but is subject to a 10 percent lifetime cap on increases; that is, it could not be greater than 14.16 percent over the life of the loan.)

The table below shows how the average total monthly cost of this loan would rise over time in 2-year increments based on a 4.16 percent and a 5.66 percent interest rate. It also averages the two monthly cost figures and adds an amortized monthly value for the \$6,000 in upfront costs to obtain the total costs per month. The table assumes that the couple purchases a LTCI policy costing \$508.32 per month (see policy details below on page 7).

<b>Total HECM Loan Costs Per Month</b>					
<b>In Years</b>	<b>Based on Initial Interest Rate (4.16%)*</b>	<b>Based on Expected Interest Rate (5.66%)*</b>	<b>Average Cost Per Month**</b>	<b>+ Upfront Costs*** Amortized</b>	<b>= Total Costs Per Month</b>
1-2	\$84	\$101	\$92	\$250	<b>\$342</b>
3-4	\$142	\$180	\$161	\$125	<b>\$286</b>
5-6	\$205	\$271	\$238	\$83	<b>\$321</b>
7-8	\$265	\$372	\$318	\$62	<b>\$380</b>
9-10	\$351	\$488	\$419	\$50	<b>\$469</b>
11-12	\$435	\$618	\$526	\$41	<b>\$567</b>
13-14	\$527	\$765	\$646	\$35	<b>\$681</b>
15-16	\$628	\$932	\$780	\$31	<b>\$811</b>
17-18	\$739	\$1,120	\$929	\$27	<b>\$956</b>
19-20	\$860	\$1,333	\$1,096	\$25	<b>\$1,121</b>
21-22	\$994	\$1,574	\$1,284	\$22	<b>\$1,306</b>
23-24	\$1,140	\$1,846	\$1,493	\$20	<b>\$1,513</b>
25-26	\$1,301	\$2,154	\$1,727	\$19	<b>\$1,746</b>
27-28	\$1,478	\$2,503	\$1,990	\$17	<b>\$2,007</b>
29-30	\$1,671	\$2,896	\$2,284	\$16	<b>\$2,300</b>

\*Includes servicing, interest, and periodic MIP. \*\*Equals average of previous two columns.

\*\*\*Equals \$6,000 in upfront costs divided by number of months since closing.

- **Increases in Monthly LTCI Cost:** The table below shows how much the monthly cost of this HECM would add to the cost of the monthly LTCI premium being paid by this couple:

- Over the first two years, the loan adds 67 percent to the cost of LTCI.
- By the time the couple reaches age 74, the monthly cost of its HECM loan (\$567) would exceed the cost of its monthly LTCI premium, adding 111 percent to the cost of the LTCI premium.
- At this couple’s approximate life expectancy (age 82), the monthly loan cost (\$1,121) would add 220 percent to the cost of the LTCI premium, for a total monthly cost of \$1,629.

The table assumes that LTCI premiums never increase and that purchasers are able to continue paying LTCI premiums indefinitely. But, as noted later in this commentary, each of these assumptions is questionable.

<b>Increases in Monthly Costs for Section 201 LTCI</b>				
<b>In Years</b>	<b>Monthly LTCI Cost</b>	<b>+ Monthly HECM Costs*</b>	<b>= Combined Monthly Cost of S. 201 LTCI</b>	<b>Monthly Cost Increase**</b>
1-2	\$508	\$342	\$850	67% per month
3-4	\$508	\$286	\$794	56% per month
5-6	\$508	\$321	\$839	65% per month
7-8	\$508	\$380	\$888	74% per month
9-10	\$508	\$469	\$977	92% per month
11-12	\$508	\$567	\$1,075	111% per month
13-14	\$508	\$681	\$1,189	134% per month
15-16	\$508	\$811	\$1,319	159% per month
17-18	\$508	\$956	\$1,464	188% per month
19-20	\$508	\$1,121	\$1,629	220% per month
21-22	\$508	\$1,306	\$1,814	257% per month
23-24	\$508	\$1,513	\$2,021	297% per month
25-26	\$508	\$1,746	\$2,254	343% per month
27-28	\$508	\$2,007	\$2,515	395% per month
29-30	\$508	\$2,300	\$2,300	452% per month

\* From previous table. \*\* Monthly HECM costs divided by monthly LTCI costs.

At this couple’s approximate life expectancy (age 82), they would have paid about \$122,000 in LTCI premiums. But they would now owe between about \$230,000 and \$276,400 on their HECM loan, depending on the interest rate charged on it. So they would have paid from about \$108,000 to \$154,400 in

loans costs. The midpoint between these outcomes, \$131,200, suggests that they would be likely to spend more on the loan than on the LTCI premiums.

- **Undisclosed Cost Increases:** The table above shows that a HECM could significantly increase the monthly cost of purchasing LTCI. But these increases would not be likely to be understood by consumers. Without specialized analyses and disclosure formats they would be unlikely to be aware that the monthly cost of their LTCI coverage would increase substantially over time due solely to increases in monthly HECM costs.

Despite the high cost of this hybrid HECM/LTCI product, Section 201 does not require any disclosure of the combined cost. Consumers would be able to see the cost of the LTCI policy. But the true cost of the HECM - particularly in relation to the cost of the LTCI - would not be disclosed to them in an understandable manner.

In fact, the Truth-in-Lending cost disclosure for reverse mortgages would obscure the true cost of HECMs used to purchase LTCI policies. The Truth-in-Lending methodology for creditline reverse mortgages requires an assumption that 50 percent of the initially available creditline amount is drawn by the borrower at closing. But purchasers of LTCI would be drawing much smaller amounts on a regular (most likely monthly) basis. As a result, the official Truth-in-Lending disclosure would systematically understate the true, total cost of Section 201 HECMs.

## **2) Inducing Consumers to Buy LTCI They Cannot Afford and May Not Need:**

It is difficult to see how adding these significant costs to the price of LTCI would be in anyone's interest.

- Homeowners who can afford the cost of LTCI without borrowing would be highly unlikely to borrow for this purpose if they knew how much the loan would add to the cost.
- On the other hand, homeowners who cannot afford to purchase LTCI at the cost of the policy alone would not be good candidates to purchase such insurance.

The Federal LTCI Program provided via the federal government's Office of Personnel Management says that "You should not buy long term care insurance if you can't afford the premiums".<sup>1</sup> But without clear cost disclosures, neither consumers nor LTCI agents would know the true, total cost of HECM-financed LTCI. Even though consumers would be unlikely to be aware of the high costs of such a combined "insurance + loan" product, it would enjoy the "halo" of an implied HUD endorsement.

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<sup>1</sup> See [http://www.ltcfeds.com/about\\_ltc/overview.html](http://www.ltcfeds.com/about_ltc/overview.html)

Moreover, consumers would be unlikely to be aware that they may not need LTCI. HUD's actuarial study of Section 201 implementation concluded that "for low-income HECM borrowers, Medicaid is a more realistic and appropriate alternative to LTCI." (page 81).<sup>2</sup> It also found that

Financing LTCI with a HECM will simply shift the burden for LTC from the public back to the less financially able elderly using the equity in their homes **to buy insurance benefits that they already qualify for under Medicaid.**<sup>3</sup>

In other words, homeowners with incomes and assets so low that they need to borrow against their homes at a relatively high cost to purchase LTCI are highly unlikely to need such insurance. But implementation of Section 201 would encourage LTCI agents to sell this high-cost combination product based on the implied endorsement of Congress and the federal government represented by the forgiveness of the upfront MIP.

**Insufficient Safeguards:** The second issue area covered in the ANPR is related to consumer safeguards associated with the LTCI policies. As the Notice indicates, Section 201 requires that LTCI policies must meet model regulations developed by the National Association of Insurance Commissioners (NAIC) in 2000. But many states have not adopted that model, and it is now out of date. Not all states that adopted the model included its suitability standards, and those standards are very weak in the area of affordability. They only require that insurers must have affordability standards. They do not require specific income and asset standards for affordability, and they do not prescribe a methodology for establishing such standards.

So even in states that have adopted the NAIC model and all of its suitability standards, each insurer is free to establish whatever income and asset affordability standards it pleases. Moreover, state enforcement of insurer-specified affordability standards has not been robust.

As a result, the risk of consumers being induced to purchase LTCI policies they cannot afford and may not need is substantial, and existing requirements do not sufficiently protect consumers against this risk. Implementation of this statute - with its federal "incentive" and lack of suitability/affordability safeguards - would increase this risk.

Moreover, Section 201 does not require an explicit disclosure that low-income, low-asset homeowners may qualify for Medicaid coverage of long-term care costs as an alternative to purchasing LTCI. As stated in HUD's actuarial analysis, "If the prospective borrower has reached the point of needing a HECM to pay the (LTCI) premium then they are likely to be eligible for Medicaid to cover LTC needs."<sup>4</sup>

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<sup>2</sup> Abt Associates, "Refinancing Premium, National Loan Limit, and Long-Term Care Premium Waiver for FHA's HECM Program," HUD Policy Development and Research Report, May 2003.

<sup>3</sup> Ibid., page 78, emphasis added.

<sup>4</sup> Ibid, page 79.

**No Evidence of Consumer Interest:** No research has demonstrated that consumers are demanding this hybrid product, that they are currently using reverse mortgages to buy LTCI in significant numbers, or that they would use a hybrid product if it were offered. Indeed, HUD's actuarial study noted the almost total lack of overlap between reverse mortgage borrowers (who have low incomes, are older, and live alone) and the purchasers of LTCI (who are younger, more likely to be married, and have more income and wealth to protect).<sup>5</sup>

But the influence of a federal incentive and implied endorsement, and the lack of protective disclosures may generate substantially more LTCI/HECM sales than would otherwise be likely. Given the high cost of this product, many if not most of its purchasers may learn too late that they cannot afford it or that they do not need it.

**3) Doing More Harm Than Good:** Consumers and LTCI agents would be unlikely to be aware that the purchase of LTCI with HECM proceeds might end up doing the buyers more harm than good. Section 201 does not require disclosure of risks related to LTCI policy cancellation or lapses, HECM loan default, or Medicaid ineligibility. Moreover, it does not require any safeguards against these risks.

**LTCI Policy Cancellation or Lapses:** Some low- or moderate-income homeowners living in modest homes who purchase LTCI with HECM proceeds could be left with neither loan benefits nor insurance coverage when they need them. For example, a 62-year-old couple living in a \$100,000 home in December of 2004 could get a HECM creditline loan of about \$49,200, assuming no upfront MIP is paid.

This couple could then use the loan proceeds to purchase a LTCI policy such as the prepackaged "Comprehensive 150+" plan offered by the U. S. Office of Personnel Management<sup>6</sup> through its Federal Long Term Care Insurance Program<sup>7</sup>. The cost of this policy for them would be \$508.32 per month.

But even assuming no increases in the policy's premium, this couple would exhaust their HECM creditline funds in about 10 or 11 years, depending on the adjustable interest rate actually charged on the loan. At the age of 72 or 73, they would no longer have any loan proceeds available with which to keep paying their LTCI premiums. If they then discontinued paying their premiums, their policy would end, and they would be without loan proceeds or insurance coverage at a time when their risk of needing LTC is growing.

The "contingent nonforfeiture" provision required by Section 201 only applies when premiums increase, not when consumers lose their ability to pay a premium that has not increased. If consumers stop paying a LTCI premium that has not increased, their policy is cancelled or lapses and their coverage ends.<sup>8</sup> Section 201 therefore creates a new kind

<sup>5</sup> Ibid, pages 74-78.

<sup>6</sup> See [www.opm.gov](http://www.opm.gov). Note that other policy options would cost less, but this policy was chosen as an example because it offers the best available consumer protection.

<sup>7</sup> See [www.ltcfeds.com](http://www.ltcfeds.com).

<sup>8</sup> If policyholders in this situation could afford to continue paying a reduced premium, they may be able to continue their coverage at a lower benefit level.

of risk not covered by LTCI policies: the risk that the reverse mortgage loan funds being used to pay LTCI premiums will be exhausted, the policyholder will no longer be able to pay the premiums, and the policy will be cancelled or lapse due to nonpayment.

In addition to losing their LTCI coverage, this couple would now owe a total debt on their home ranging from about \$89,000 to \$97,000, depending on the interest rate charged on the loan. If LTCI policy cancellation or lapse does not cause the HECM to become due and payable, this debt would grow larger, even though its benefits have terminated. By the age of 82 - the approximate median life expectancy of the couple - the debt would range from about \$147,000 to \$200,000 depending on the interest rate. So the median lifetime cost of the loan - subtracting the principal advances used to purchase LTCI for 10 or 11 years - would range from about \$85,000 to \$130,000.

Various factors would affect the point at which borrowers exhaust their loan proceeds. Higher interest rates at closing generally would accelerate the process while higher home values at closing would delay it, as shown in Appendix A on page 16. Initially lower LTCI premiums would delay the process, but would provide less comprehensive coverage and less consumer protection. Rising LTCI premiums would speed up the exhaustion of loan proceeds, and premium increases are common in this market.

The risk of policy cancellation or lapse adds significant complexity and risk to the combined LTCI/HECM transaction for consumers. Both LTCI and HECMs are complex products. The combination of these products would multiply the complexity and increase the likelihood that some borrowers would exhaust their loan proceeds, lose some or all of their LTCI coverage, and end up with a large and growing debt on their most important financial asset.

The contingent nonforfeiture and suitability provisions of Section 201 would offer no protection against these risks. Suitability standards are usually related to a consumer's current income and assets. They do not take into account the situation in which a consumer's ability to pay for LTCI is tied to an available creditline that is not inexhaustible. At a minimum, any reasonable suitability standard for this type of hybrid product should proscribe sales of LTCI via HECM financing when the creditline is unlikely to be able to pay the premiums over the borrower's lifetime. Such a standard would have to take into account the remaining life expectancy of the borrower, the monthly cost of the LTCI premium, and the initial creditline available to the borrower.

However, even a suitability safeguard of this type could not prevent creditline exhaustions from occurring in all cases. The most effective safeguard would have to reflect the most expansive assumptions about future LTCI premium increases and the length of time before borrowers would need LTCI benefits. For example,

- In April of 2004, one LTCI carrier increased rates by 50%, and “only three of the top ten companies did not have fairly significant rate increases.”<sup>9</sup>
- Many LTCI policyholders never need LTCI benefits, and some of them are very long-lived.

A safeguard that reflected both of these facts would severely restrict program eligibility. But any less restrictive safeguard would increase the likelihood of creditline exhaustions occurring. Any reasonable assumption about premium increases would in some cases be exceeded by “unreasonable” increases. And any reasonable assumption about the incidence and timing of long term care needs would also be exceeded in some cases.<sup>10</sup> In any implementation of Section 201, therefore, some creditline exhaustions would be highly likely to occur, with the resultant policy cancellations and lapses leaving some consumers in much worse financial shape than if Section 201 had not been implemented.

ANPR Issue No. 5 asks if it would be possible to devise a limitation on the use of Section 201 HECMs for retiring outstanding mortgage obligations that would assure that adequate funds would remain available to fund LTCI insurance. The discussion above makes it clear that even if this limit were set as low as \$1, there would be no assurance that adequate funds would remain to fund LTCI premiums for all policyholders until they need LTCI benefits. (Any amendment to Section 201 to permit additional uses of loan proceeds would increase the likelihood of policy cancellations or lapses due to an inability to pay the premiums. It would also raise new disclosure issues about the implications of allocating loan funds in ways that might jeopardize LTCI coverage.)

**HECM Loan Default Risk:** The exhaustion of loan proceeds, as discussed above, could lead to the loss of LTCI coverage and a large and growing debt on a consumer’s home. But these would not be the only hazardous results. Alternately, consumers could lose their LTCI coverage and lose their homes. The ANPR suggests a number of new LTCI-related conditions that could make a HECM loan due and payable, for example,

- 1) the temporary or permanent move-out of a non-owner family member covered by LTCI purchased with loan proceeds,
- 2) the use of loan proceeds for non-approved purposes, or
- 3) the termination of a qualifying LTCI policy - even if it occurs due to unanticipated or inappropriate action by the insurer.

<sup>9</sup> <http://www.aarp.org/bulletin/longterm/Articles/a2004-03-24-bigpremium.html>

<sup>10</sup> Fifty percent of the population at any given age outlives its remaining life expectancy. But the percentage would be higher for LTCI policyholders because of medical underwriting. So to cover even one-half of the LTCI/HECM participants, the safeguard’s assumption about remaining life expectancy would have to be greater than the median. To cover a more substantial portion of participants, say, 75 percent, the assumption would have to be greater than 150 percent of the median, et cetera.

In these cases, borrowers would face foreclosure and most likely would have to sell their homes in order to repay their loans, leaving them without LTCI coverage, without their homes, and in many cases with significantly less net worth and a diminished capacity to pay for basic necessities. The respective causes of these foreclosures could be

- 1) a non-owner daughter covered by the LTCI policy moving out to provide caregiving in the home of an aunt,
- 2) the use of loan proceeds to widen doorways to accommodate a wheelchair, or
- 3) policy cancellations or lapses due to the exhaustion of HECM creditlines, unanticipated premium increases, or the insurer's departure from the LTCI market.

When such loan defaults and foreclosures would occur prior to the collection of LTCI benefits, the borrowers involved would indisputably end up in much worse shape than if Section 201 had not been implemented.

The loss of one's home due to the exhaustion of a HECM creditline would be all the more egregious because it would reflect a conscious policy decision to create a federal incentive highly likely to lead to this result in some cases. Clearly disclosing this possible outcome in unmistakable detail would be the least that HUD could do to lessen the likelihood that unsuspecting homeowners would be induced to assume this risk unaware of the potential consequences. A more effective approach would be to communicate the real possibility of this unintended consequence to the Congressional committees responsible for enacting Section 201.

**Medicaid Ineligibility Risk:** When LTCI benefits are not sufficient to cover the cost of care, LTCI beneficiaries may qualify for Medicaid benefits to cover some or all of the shortfall. But if their LTCI benefits are paid to them rather than to the provider of care, these benefits may make them ineligible for these supplemental Medicaid benefits. (For more on the impact of Section 201 on Medicaid, see Appendix B on page 17.)

## **B) HARMFUL TO THE REVERSE MORTGAGE INDUSTRY**

Implementation of Section 201 would be harmful to the reverse mortgage industry because it would expose it to negative reactions from consumers, require new administrative costs that would be disproportionate to accompanying benefits, and generate new types of problematic loan defaults and rescissions.

**Consumer Confidence Risk:** Consumer perceptions of the reverse mortgage market have been scarred in the past by the sale of questionable products and services via HECM financing. These episodes have garnered high-profile media coverage and tarnished an industry that is just beginning to grow. This industry has very little to gain and much to lose from being directly linked to the inappropriate sale of LTCI policies that consumers cannot afford, may not need, and that may do more harm than good.

Inappropriate sales of products or services via HECM financing have been such a serious problem for this industry that the HECM program's prime investor, Fannie Mae, has for the past six years required HECM lenders to give consumers a brochure called "Five Steps for Safety." One of the five steps tells consumers that a Fannie-funded HECM is "**never** contingent" on their spending the loan's proceeds in any particular way. Another cautions them to

insist that all reverse mortgage funds be paid directly to you. . . .  
Even if you plan to use the money to pay someone else later, the funds should **always** come to you first. Don't let anyone else persuade you to "sign over" the funds. Fannie Mae-authorized lenders are obligated to make the check payable to you and to no other third party.<sup>11</sup>

Echoing this concern, AARP's website and consumer guide to reverse mortgages include the following cautions:

Be cautious when anyone who wants to sell you something suggests a reverse mortgage as a way to pay for it. Be especially wary if:

- you do not fully understand what they are selling; or
- you are not certain that you need what they are selling.

Remember that the total cost to you equals the cost of what they are selling plus the cost of the reverse mortgage. If you need what they are selling, be sure to shop around before buying. You don't have to buy goods or services from the person who suggested you borrow against your home to pay for them. In fact, that's the person to be careful about.<sup>12</sup>

Section 201 HECMs would pose even greater risk to consumers and the reverse mortgage industry's public image than did the sale of other questionable products via HECM financing that led to these cautions by Fannie Mae and AARP. All LTCI/HECM participants would pay a very high, undisclosed price for their LTCI coverage. And some of them would also exhaust their HECM loan proceeds, causing them to lose their LTCI coverage, a substantial portion of their home equity, and possibly their homes. This outcome would be a substantially more negative outcome than any heretofore caused by sales of questionable products via HECM financing.

In short, the reverse mortgage industry has already been negatively affected by the sale of questionable goods and services via HECM financing. The strong institutional response to this problem by Fannie Mae in particular suggests that opening the door

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<sup>11</sup> Fannie Mae. "Your Reverse Mortgage: Five Steps for Safety." (brochure)

<sup>12</sup> See <http://www.aarp.org/revmort/Articles/a2003-03-27-equity.html>.

to problematic HECM-financed LTCI sales would not be in the best interests of the industry. Indeed, Fannie Mae and other potential investors would be ill-advised to purchase HECMs with use restrictions linking them to the purchase of LTCI (see “Foreclosure Risk” below).

**Administrative Costs:** Reverse mortgage loan officers, underwriters, and servicers would be in the front lines of delivering this complex new program. No matter how HUD would answer the questions in its ANPR, these lending officials would have the responsibility of learning, explaining, interpreting, and dealing with consumer questions, concerns, and complaints about these policies. The amount of time and effort needed to learn and administer this hybrid program is unlikely to be worth the amount of new business it attracts and the public relations risks it presents.

In particular, as ANPR Issue No. 4 suggests, HECM industry personnel would bear some level of responsibility for making sure that 1) LTCI policies meet HUD’s disclosure, suitability, non-forfeiture, and other standards, and 2) HECM proceeds are used for no purposes other than retiring a prescribed amount of existing debt or purchasing a qualified LTCI policy. Failure to meet those responsibilities would presumably be grounds for loan rescission or default.

These additional administrative tasks and responsibilities would likely add significant costs to the origination and servicing of these loans. If origination and servicing fee limits do not increase, the industry would have to absorb these cost increases. When originators sell servicing rights to these loans, however, servicers would be unlikely to pay as much as they do for the rights to HECMs without the added LTCI costs. If origination and servicing fees are increased to accommodate these increased costs, then the already high cost of purchasing LTCI via HECM financing for consumers would increase as well.

**Foreclosure Risk:** The most troublesome specific aspect of Section 201 for the reverse mortgage industry would most likely be its new default triggers (see “HECM Loan Default Risk” on page 9). At present, loan defaults due to nonpayment of property taxes and homeowner’s insurance are a major problem for the HECM program’s prime investor, Fannie Mae. To cure these defaults, Fannie Mae would have to initiate foreclosure proceedings. Thus far, Fannie Mae has not done so, presumably due to the public relations implications.

No one involved in the HECM program’s development ever anticipated that Fannie Mae would end up having this responsibility, and Fannie Mae has not priced this risk into its interest rate margins. But the problem is so serious that Fannie Mae has not implemented a HECM interest rate lock and a reduction in origination fees for HECM refinancings enacted by Congress because it believes these features would exacerbate the default problem.

The new default triggers required by Section 201 would create new types of default that would present troublesome new foreclosure issues described above on pages 9-10. Given these and other problems associated with Section 201 discussed in this commentary, Fannie Mae would be ill-advised to purchase HECMs tied to LTCI purchases. As noted

earlier (under “Consumer Confidence Risk” on pages 10-11), Fannie Mae also has a long-standing policy against HECM use restrictions or requirements and third-party payments in the HECM program.

AARP would support a decision by Fannie Mae not to purchase HECMs tied to required LTCI purchases because it would protect consumers from the hazards discussed in this commentary. If Fannie were to take this action, the LTCI program provided by Section 201 would not exist unless some other investor decided to purchase these loans.

**Rescission Risk:** At present, loans originated in violation of certain federal requirements are subject to rescission at any future time due to the harm that such violations can do to borrowers. LTCI/HECM loans presumably would have requirements related to the HECM loan, the LTCI policy purchased with the loan, and suitability standards related to exhaustion of HECM creditlines as discussed under “LTCI Policy Cancellation or Lapses” on page 7.

Due to the harm that violations of the LTCI policy and suitability requirements could do to borrowers, these non-loan requirements could also make these loans rescindable at any future time. To clarify this issue, HUD should seek a legal opinion regarding the rescindability of HECM loans due to such violations.

### **C) HARMFUL TO THE HECM PROGRAM**

Implementation of Section 201 would be harmful to the HECM program principally because it would be harmful to consumers and to the reverse mortgage industry in the ways discussed in this commentary. These problems, in turn, would undermine consumer and industry confidence in the HECM program.

Section 201 implementation would also harm the HECM program because it would require HUD to become a LTCI regulator, jeopardize the actuarial soundness of the program, and prevent more desirable policy options.

**HUD as LTCI Regulator:** To implement this program, HUD would have to establish standards for LTCI policies and then either determine which policies meet the standards or be responsible for ensuring that HECM lenders, underwriters, and servicers are correctly determining which policies meet the standards. Neither HUD nor HECM industry personnel have the expertise these roles require, and neither is well-suited to carrying out these roles. LTCI policies are complex and can vary from state to state due to state regulations.

HUD and industry personnel would have to invest substantial time and effort to acquire, maintain, and utilize the expertise they would need to carry out a program that may attract few participants. No matter how many participants are involved, however, the problems this program would create for consumers suggests that a substantial proportion of its participants would be likely to present related problems for HUD and industry personnel.

**Risks to the HECM Insurance Fund** – HUD’s actuarial study estimated that the FHA would lose approximately \$1,000 per loan used to purchase LTCI. If insurance agents are able to induce substantial numbers of homeowners to participate in this program, HUD would need to compensate for these losses. But none of the options for doing this are attractive.

- Increasing the MIP for other HECM borrowers would transfer costs from relatively young, healthy, and wealthy borrowers (who are more likely to purchase LTCI) to older, poorer, and sicker borrowers (who typically do not qualify for LTCI).
- Seeking an appropriation from Congress is unlikely to solve the problem, as Congress has been loath to subsidize mortgage insurance programs.
- Transferring the costs to other loan programs administered by FHA could jeopardize the HECM program if it were to become a significant cost.
- Reducing the loan amounts to LTCI program participants could solve the problem, but it would decrease the usefulness of the program and increase default risk on these loans.

Alternately, the HECM insurance fund may be able to absorb the losses if an actuarial analysis finds it has been charging higher than necessary premiums. But absorbing the losses - if they are substantial - would reduce or eliminate HUD’s ability to implement more desirable HECM improvements such as:

- reducing the MIP for traditional HECM borrowers, who are older, poorer and sicker than those who would be likely candidates to purchase LTCI;
- establishing a single national loan limit, which in many cases would allow homeowners to access more of their equity; or
- reducing the MIP for homeowners with disabilities who are at immediate risk of needing LTC supports.

## CONCLUSION

***Given the large and unsolvable problems associated with linking reverse mortgages to the purchase of long term care insurance, HUD should suspend the implementation process and urge the appropriate authorizing committees of Congress to repeal Section 201.***

Section 201 of the American Homeownership and Economic Opportunity Act of 2000 was undoubtedly offered with the best of intentions in seeking to help older homeowners meet their needs for services in the event of a disability. AARP especially applauds the intention to reduce the high costs associated with reverse mortgages for those facing long-term care costs. But if such efforts are to be supported in this fashion, then it would be more beneficial to target such efforts on older homeowners with disabilities who are

struggling to remain independent in their homes and are not eligible for LTCI. Reducing not only the mortgage insurance, but also origination and servicing fees would promote the independence of those most at risk of needing long-term care services.

AARP has been a long-standing partner with HUD, Fannie Mae, and representatives of the lending industry in establishing the HECM program and the consumer disclosure and counseling that are required by the program. Repealing the Section 201 link between LTCI and reverse mortgages could open up more fruitful opportunities for assisting older homeowners at risk of needing long-term care services. We look forward to continuing to work with these partners to reduce the costs of reverse mortgages and make further improvements to the program in the future.

**Appendix A: Age at Which a 62-Year-Old Couple  
Would Run Out of HECM Loan Funds  
to Pay Monthly LTCI Premiums**

**Assumptions:**

- o Loan = Monthly-adjustable HECM\*
- o Upfront MIP on HECM = none
- o Future increases in variable rate loan = none (rate cap = 10 percentage points)
- o Cost of monthly premium = \$508.32\*\*
- o Future increases in annual premium = none

	Interest Rate Used To Calculate Loan Amounts***					
	Rate on 12/15/04		Rate on 12/15/04 + 1%		Rate on 12/15/04 + 2%	
Home Value at Closing	Loan Amount	Age at which loan funds <\$508.32	Loan Amount	Age at which loan funds <\$508.32	Loan Amount	Age at which loan funds <\$508.32
\$100,000	\$49,200	<b>Age 72</b>	\$38,700	<b>Age 69</b>	\$30,100	<b>Age 68</b>
\$150,000	\$77,900	<b>Age 81</b>	\$61,800	<b>Age 76</b>	\$48,700	<b>Age 73</b>
\$200,000	\$109,600	<b>Age 97</b>	\$84,900	<b>Age 88</b>	\$67,200	<b>Age 81</b>

\* HECM is the federally-insured Home Equity Conversion Mortgage; loan amounts for annually adjustable rate HECMs are less than the amounts in the table, which are for monthly adjustable rate HECMs.

\*\* The \$508.32 premium for a 62-year-old couple is amount charged on 12/15/04 by the Federal Long Term Care Insurance Program offered by the U. S. Office of Personnel Management ([www.opm.gov](http://www.opm.gov); [www.ltcfed.com](http://www.ltcfed.com)) for its prepackaged "Comprehensive 150+" plan. .

\*\*\* The rate used to calculate HECM loan amounts on 12/15/04 (5.69%) is near the HUD minimum floor of 5.5%. To show a range of outcomes based on higher rates, the table adds 1% and 2% to the current rate. For example, the +1% rate (6.69%) was last used to calculate HECM loan amounts May of 2002; the +2% rate (7.69%) was last used in June of 2000. The rates used to grow the remaining available creditline amounts to generate these additional outcomes are also increased by 1% and 2%.

### **Appendix B: Medicaid, Long-Term Care Insurance, and Reverse Mortgages**

Interest in linking the purchase of long-term care insurance (LTCI) and reverse mortgages stems, in part, from the desire to save money under the Medicaid program, which currently subsidizes the payments of most nursing home costs. States are understandably concerned about the growing portion of their budgets going to pay long-term care costs.

*However, forgiving the upfront mortgage insurance for reverse mortgages devoted to the purchase of LTCI is highly unlikely to result in significant Medicaid savings and could even result in additional costs to the program for several reasons:*

- *Any meaningful suitability standards required under the program would preclude sales of LTCI to older homeowners who are most at risk of needing Medicaid assistance with long-term care costs;*
- *Older homeowners with modest home values would have a high likelihood of exhausting their equity and allowing their LTCI policies to lapse before they reached the point of needing assistance;*
- *Even those homeowners who reach the point of needing assistance may elect to drop their private LTCI if the benefits are insufficient to pay for the services they need; and*
- *Dedicating home equity to the purchase of LTCI precludes other options more likely to benefit consumers and save modest amounts of money for Medicaid.*

#### **Suitability**

Suitability standards are designed to prevent sales of LTCI to consumers who cannot afford the premium payments and are likely to be eligible for Medicaid coverage in the event of a disabling illness or condition. The comments above discuss the inadequacies of current suitability standards, especially as they might apply to the circumstance in which an older homeowner is dependent on an exhaustible creditline to make the insurance payments. If adequate suitability standards are implemented and enforced, they would screen out consumers who are most at risk of needing Medicaid assistance. In other words, if LTCI sales are targeted only to those consumers who have relatively high incomes and assets, then significant Medicaid savings are not very likely. Adding suitability standards related to the hybrid LTCI/reverse mortgage product would also severely limit the potential number of consumers who would qualify.

#### **Risk of Exhausting Equity**

As noted in the comments above, a 62-year-old couple with a home valued at \$100,000 is highly likely to run out of equity to make LTCI payments before they need the benefits. However, even homeowners with higher home values would be at risk, especially if premiums increased or if they live beyond the median life expectancy. By definition, half of the population will live beyond the median, but the purchasers of LTCI are much more

likely to live longer due to the medical underwriting required to purchase insurance. Unless older homeowners have a relatively high valued home, they are very likely to run out of equity before they need long-term care services. And unless they have sufficient income when the equity runs out, they are likely to allow their policies to lapse. In such an event, not only would they be at high risk of needing Medicaid assistance in the event of a disability, but they would have significantly reduced or exhausted the home equity available for Medicaid to recover through estate recovery.

### **Risk of Dropping Coverage**

A recent Issue Brief by AARP's Public Policy Institute discusses some unanticipated consequences that may result from the interaction of private LTCI and Medicaid eligibility.<sup>13</sup> As the Issue Brief notes, consumers who have purchased LTCI rarely have complete coverage of all costs associated with a disability. Any additional costs must be paid out of pocket. Consumers who have purchased low cost, low benefit plans are most likely to have to pay significant amount of money out of pocket, especially if they did not purchase inflation protection as part of the policy. In some cases, Medicaid may be able to pay for some of the additional cost if the consumer is unable to pay. But in other cases, the LTCI benefit may make consumers ineligible for Medicaid.

If consumers are unable to pay for the services that exceed their LTCI coverage, they may be forced to drop their LTCI coverage in order to qualify for Medicaid. Once again, Medicaid would end up paying for the services with the home equity having been exhausted to pay for largely useless LTCI coverage.

### **Precluding Other Possibilities**

The Section 201 provisions require that all proceeds from reverse mortgages must be used for the purpose of purchasing LTCI. Such a requirement precludes the possibility that homeowners might use their equity for other purposes that might be more in their interests. When surveyed, older people invariably indicate a strong preference for receiving long-term care services in their own homes if at all possible. Remaining at home often requires major home modifications whose costs are not covered by private LTCI or Medicaid. In such a circumstance, the older homeowner may be forced into more costly institutional care that they do not want because they have no means to pay for home modifications or supplementary services not covered by their insurance.

Saving Medicaid funds and enabling older homeowners to remain in their homes will be best served by finding alternatives to using home equity to pay for private LTCI. Coupling Medicaid home care coverage with lower cost reverse mortgages for home modifications and supplemental services would likely have much more positive impacts than the current statutory provision linking reverse mortgages to the purchase of LTCI. HUD and the Centers for Medicare and Medicaid Services (CMS) should work with states, consumer advocates, and industry representatives to find ways to reduce the costs of reverse mortgages for older homeowners who are facing the loss of their independence

<sup>13</sup> See Kassner, Enid, "Private Long-Term Care Insurance: The Medicaid Interaction," AARP Public Policy Institute Issue Brief Number 68, 2004 for a more thorough discussion of the issue raised in this section.

due to a disability. AARP looks forward to such discussions of alternative ways that home equity may play a role in financing long-term care costs.

The Honorable Barney Frank  
Chairman  
Financial Services Committee

The Honorable Maxine Waters  
Chairwoman  
Subcommittee Housing and Community Opportunity  
Financial Services Committee

Dear Chairman Frank and Chairwoman Waters:

We support your efforts to inject new energy into the Federal Housing Administration (FHA) mortgage insurance program. As Department of Housing and Urban Development (HUD) housing counseling intermediaries we help hundreds of thousands families achieve the American Dream. Our organizations have a long history working with FHA and its target borrowers. We have witnessed firsthand FHA's diminishing presence in the mortgage market. In some cases, FHA's declining market share has left a hole in the marketplace that has been filled with loan products that have not served our families well. We share your goal of restoring and expanding the FHA program and providing sustainable homeownership opportunities to underserved families.

For over 70 years the Federal Housing Administration (FHA) has contributed to the expansion of homeownership opportunities. FHA has accomplished this by focusing on the needs of first time homebuyers and through product innovations, such as the 30 year amortizing mortgage and low downpayment requirements. To remain true to its mission, FHA must continue to study the market to understand the needs of underserved communities. Then, create products that meet their needs. We support your work in H.R. 1852 to ensure that FHA can remain competitive and true to its mission. Specifically, we applaud your efforts to increase the FHA loan limits in high cost markets, create incentives to reward on time payments, and expand opportunities for homeownership counseling.

As advocates for first-time homebuyers and other groups underserved by the mortgage market, we firmly believe that borrowers who receive riskier products – such as zero downpayment or adjustable rate mortgages – stand to benefit greatly from homeownership counseling. Research shows that families that complete our homeownership counseling programs are less likely to default than families that did not receive counseling. Moreover, for families that did not have the benefit of prepurchase counseling, the availability of post-purchase services is critical. When a family is facing an unexpected financial emergency, time is the enemy. The sooner they are in touch with a homeownership counselor, the more options will be available to them to save their home. H.R. 1852 addresses both pre- and post-purchase counseling. Although not mandatory, the bill creates new opportunities for pre-purchase counseling and helps get the word out about counseling services. It also creates a new tool for counselors to get in early contact with delinquent FHA borrowers – the “opt-in” provision available to families at closing. We believe

the counseling provisions in H.R. 1852 will create new and important avenues for underserved families to access homeownership counseling when they need it most.

We would also like to offer three recommendations to further strengthen the bill.

- **Support existing capacity and expand services in the housing counseling field.** In a dynamic marketplace, housing counseling agencies work hard to maintain the level of service necessary to meet demand. This means ensuring they have skilled and diverse staff that can provide a variety of types of counseling – loss mitigation, homeownership planning, predatory lending, and financial management. To support existing capacity and expand services to new communities, housing counseling agencies need a dedicated source of funding. We recommend authorizing the HUD housing counseling program for \$100 million. Housing counseling agencies should also be able to earn fees for their work to prepare families for ownership and prevent foreclosure.
- **Solidify the incentive to obtain homeownership counseling before purchase.** In the past, FHA has offered incentives for borrowers to receive counseling. Unfortunately, this practice was discontinued while FHA faced challenges with fraudulent players in the mortgage industry. We recommend reinstating the discount on upfront mortgage insurance premium for timely pre-purchase homeownership counseling, but only when counseled by a HUD certified counseling agency. Moreover, we call on HUD to consider pre-purchase counseling as credit enhancement in the risk-based pricing equation, since counseled clients are less likely to default on their loan.
- **Guarantee FHA borrowers receive loss mitigation services.** We applaud the authors for including an “opt-in” privacy waiver for FHA borrowers. This waiver will allow borrowers another avenue to preserve their home in times of financial crisis. However, the bill language states that once a borrower signs the privacy waiver, authorizing a servicing company to share their information with an approved housing counseling agency, the servicer is not required to send the notice in event of a default. If a borrower signs the waiver, we believe the borrower is affirmatively indicating their desire to receive loss mitigation assistance. We recommend requiring servicers to honor the borrower’s request.

Again, we applaud your efforts to expand sustainable homeownership to underserved families. We look forward to working with you. If you have questions on this issue, please contact Brenda Muniz, ACORN, at (202) 547-2500 or Janis Bowdler, National Council of La Raza (NCLR), at (202) 841.9581, or Michael Turner, National Foundation for Credit Counseling (NFCC) at (301) 576-2542.

Sincerely,

ACORN  
HomeFree-USA  
Housing Partnership Network  
Mission of Peace

The Mon Valley Initiative  
National NeighborWorks Association (NNA)  
National Council of La Raza (NCLR)  
National Foundation for Credit Counseling  
NeighborWorks America  
Rural Community Assistance Corporation

**Testimony of**

**Peter H. Bell, President  
National Reverse Mortgage Lenders Association**

**Submitted to  
The Subcommittee on Housing and Community Opportunity  
The Committee on Financial Services  
U.S. House of Representatives**

April 19, 2007

National Reverse Mortgage Lenders Association (NRMLA) is pleased to submit testimony in support of H.R. 1852, the Expanding Homeownership Act of 2007. Introduced by Reps. Barney Frank and Maxine Waters, H.R. 1852 would streamline and improve FHA single-family loan programs, including the Home Equity Conversion Mortgage (HECM) program. NRMLA commends Chairman Frank and Chairwoman Waters for their leadership and recognition of the importance of reverse mortgages and salute their willingness to make innovative improvements that will make the HECM program more beneficial to seniors nationwide.

As the national voice of the reverse mortgage industry, NRMLA serves as an educational resource, policy advocate and public affairs center for reverse mortgage lenders and related professionals. NRMLA was established in 1997 to enhance the professionalism of the reverse mortgage business. In that capacity, NRMLA educates consumers about the pros and cons of getting a reverse mortgage, trains lenders to be sensitive to the needs of older Americans, enforces our Code of Conduct and Best Practices, and promotes reverse mortgages in the news media.

As you know, reverse mortgages enable senior homeowners 62 or older to convert part of the equity in their homes into tax-free cash without having to sell, move, give up title, or take on new monthly mortgage payments. Borrowers are never, under any circumstances, forced to leave their homes providing they make their real estate property tax and insurance payments. Borrowers can choose to receive reverse mortgage funds as a lump sum, fixed monthly payments (for up to life), line of credit, or as a combination of these. No mortgage payments are due during the life of the loan. Borrowers can use the funds anyway they wish. The loan is repaid when the last surviving borrower (in the case of a couple) sells the home or permanently moves out.

The most widely used reverse mortgage, accounting for an estimated 90 percent of the marketplace, is the FHA-insured Home Equity Conversion Mortgage, or "HECM." Since its adoption in 1990, FHA has insured almost 300,000 HECMs. Nationwide, in 2006, some 76,000 seniors—almost double the number from the previous year—obtained a HECM to pay off existing debts, fund health care expenses, pay for modifications to

make their homes safer and more comfortable, or simply to create an income stream that provides additional cash and peace of mind.

The proposed reform package would make the following improvements: 1) Eliminate the HECM loan cap; 2) Permit HECM for home purchase; 3) Allow HECMs on housing cooperatives; 4) Require HUD to study the impact of reducing mortgage insurance premiums, and exempting borrowers from paying any MIP if all, or a portion, of the loan proceeds are used to purchase long-term care insurance; and 5) Increase FHA Lending Limits.

#### **Eliminating HECM Cap**

In response to rapid growth in the reverse mortgage program, a key legislative priority for NRMLA in 2007 is focused on removing the cap on the number of reverse mortgages that FHA can insure. By law, the Department can only insure 275,000 HECM loans. Legislation (H.J. Res. 20) was approved earlier this year that "suspends" the cap through September 30.

When Congress first authorized the HECM program in 1987, it was created as a demonstration program and the number of loans that could be made was limited. The idea back then was to gain some experience with the program and observe how it performed. In 1998, Congress adopted legislation making the program permanent, but set a cap of 150,000 HECM loans that could be outstanding. Early last year, production of HECM loans began to bump up against that cap and HUD took steps to shut down new loan origination activity. To avoid this, just in the nick of time, Congress increased the HECM authorization cap to 250,000 loans in a supplemental appropriations bill that was about to be enacted. Before the end of the last Congress, the cap was increased one more time to its current level of 275,000 loans.

The passage of H.J. Res. 20 enabled the HECM program to continue without interruption, but demonstrated the need to eliminate the cap. Had there not been an appropriate legislative vehicle moving forward at precisely that time, seniors would have been shut off from the opportunity to utilize FHA-insured reverse mortgages to tap the equity in their homes.

The proposed FHA reform bill would permanently eliminate this uncertainty and create a market environment in which existing and new participants could bring down costs to consumers through product innovation and competition. A performance track record of the HECM program has now been clearly established. The program was initially designed with the intent of producing a "break even" cash flow. It has far surpassed that and yielded a significant surplus. It is time to remove the HECM loan volume cap so this important program can help more seniors live comfortable lives in their own homes.

#### **HECM for Home Purchase Option**

Although the reverse mortgage was originally conceived as a financial tool to help seniors stay in their current homes, it is evident that some homeowners may want to use reverse mortgages to purchase new homes that are better suited to their current needs or

closer to their families. Newer homes might be preferred because they require less maintenance or have a single-story design, making it easier to “navigate” the home. The reverse mortgage should be recognized as a tool to help individuals buy homes that better serve their needs without having to exhaust cash reserves or take on new monthly mortgage payments.

NRMLA strongly believes that the use of HECM loans for the purchase of new homes is consistent with the intent of the program to help seniors live comfortably in homes of their own. We urge Congress to provide HUD with the authorization to insure loans used for this purpose.

#### **HECMs on Housing Cooperatives**

Currently, HECMs can be obtained on single-family homes, manufactured homes built after June 1976, qualified condominiums, and townhouses. In December 2000, Congress passed, without controversy, Section 201 of the American Homeownership and Economic Opportunity Act (PL 106-569), which instructed HUD to expand the HECM program to include units in housing cooperatives.

Today, over 1.2 million families enjoy homeownership through a housing cooperative throughout the United States, with large numbers located in major urban areas such as New York City, Washington, D.C., Chicago, Miami, Minneapolis, Detroit, Atlanta, and San Francisco. Cooperative members own shares in a corporation that owns or controls the building in which they live. Each shareholder is entitled to occupy a specific unit and has a vote in the corporation. Every month, shareholders pay an amount that covers their proportionate share of the expenses of operating the entire cooperative, which typically includes underlying mortgage payments, property taxes, management, maintenance, insurance, utilities, and contributions to reserve funds.

Deleted:

While shares in a co-op are technically personal property in most states, Federal regulations since the late 1970's have treated loans secured by those shares as real estate loans. FHA has had a single family loan program, Section 203n, since that time, and Fannie Mae has had a robust secondary market program for share loans for almost 25 years. Large national banks, including Bank of New York, National Cooperative Bank and Washington Mutual, have routinely offered conventional financing on cooperatives for many years.

HUD supports allowing HECM loans on housing cooperatives and we urge Congress to implement this section of H.R. 1852, so that thousands more seniors can utilize the reverse mortgage program to live more financially secure retirements.

#### **MIP Study**

Under the HECM program, borrowers are charged a mortgage insurance premium (MIP), equal to 2 percent of the home value or FHA county lending limit, whichever is less, plus an annual premium thereafter equal to 0.5 percent of the loan balance. The MIP is an important consumer protection that guarantees if the company managing the borrower's account – commonly called the loan “servicer” – goes out of business, the FHA will step

in and make sure the borrower has continued access to his or her loan funds. Furthermore, the MIP guarantees borrowers that they will never owe more than the value of their home when the HECM must be repaid.

Nevertheless, the MIP represents a significant upfront cost, especially in high-cost areas where it can equal more than \$7,000. Last year, NRMLA convened a Reverse Mortgage Working Group to begin discussions on developing a lower cost version of the HECM. While these discussions are going on, private lenders are developing conventional reverse mortgage products with low or no-cost features.

NRMLA has conducted several actuarial analyses, all of which conclude that the 2 percent mortgage insurance premium that FHA is charging upfront more than covers the cost of administering the HECM program. In fact, we believe that FHA has room to reduce the MIP altogether, or at the very least to redistribute more upfront MIP to the amount charged annually on the outstanding loan balance.

We support Congress' efforts to ask HUD to study these issues and to develop a recommendation that benefits consumers.

#### **Higher FHA Lending Limits**

NRMLA supports Congress' efforts to increase FHA lending limits, especially in high-cost areas. However, for many years, NRMLA has advocated a single national loan limit for the HECM program.

The FHA mortgage insurance programs were established by Congress to enable families that might not be able to obtain a mortgage with private mortgage insurance to purchase modest homes. Because housing costs vary considerably from market to market, Congress established loan limits for FHA that also vary according to the median home price in each market, with a cap for very high-cost areas based on the loan limits for Fannie Mae and Freddie Mac. With this system, a maximum-amount FHA loan should purchase about the same modest amount of housing in any market.

However, the FHA HECM program was established by Congress to enable elderly homeowners to convert their home equity into cash to help pay for living expenses. These expenses, which can include health care and home maintenance, do not vary considerably from market to market, and have little if any relationship to the median home price of the area. The disparities in the current FHA loan limits mean that a senior homeowner living in a city with a low FHA loan limit cannot access as much of his or her home equity as can a senior living in a city with a high FHA limit, regardless of their relative need for the funds. This unfairly penalizes senior homeowners in low-cost areas.

In addition, the variances in loan limits are confusing to seniors. It is difficult for lenders to undertake nationwide marketing efforts for HECMs and create standard explanatory materials that can help homeowners determine how much income they could get from a HECM. This has inhibited the growth of the program and prevented more widespread publication of information about reverse mortgages. As a result, many senior

homeowners still do not know they can get a federally-insured reverse mortgage that could dramatically improve their quality of life.

For these reasons, we would ask Congress to consider amending the existing bill and including language that would create a single national loan limit for HECM.

**Conclusion**

A healthy, active HECM program could be a key component for helping seniors take control over their financial situation. Reverse mortgages are a promising way to unlock billions of dollars in home equity, providing financial security, independence, and great improvement in the quality of life for thousands of senior homeowners and their families. Wider acceptance of reverse mortgages can mean reducing the need for costly increases in federal spending on health care and other benefits for seniors in the future.

The FHA Home Equity Conversion Mortgage is the primary source of reverse mortgages. Congress should enact HUD's proposals to make needed changes that will result in more senior homeowners enjoying the benefits of this outstanding program.

NRMLA and all of our member lenders stand ready to assist Congress and HUD in this vitally important effort.

Respectfully Submitted,  
Peter H. Bell, President  
National Reverse Mortgage Lenders Association  
Washington, DC

TESTIMONY SUBMITTED BY THE:

**CONSUMER MORTGAGE COALITION**

BEFORE THE

**SUBCOMMITTEE ON HOUSING AND COMMUNITY  
OPPORTUNITY OF THE COMMITTEE ON FINANCIAL  
SERVICES**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**“The Expanding American Homeownership Act of  
2007: H.R. 1852 and Related FHA Modernization  
Issues”**

April 19, 2007

The Consumer Mortgage Coalition (“CMC”), a trade association of national residential mortgage lenders, servicers, and service providers, appreciates the opportunity to submit its written testimony concerning recent developments in the residential mortgage market to the Subcommittee on Housing and Community Opportunity of the House Committee on Financial Services.

As the Subcommittee is aware, the residential mortgage lending market has evolved dramatically in recent years and decades. Although the Federal Housing Administration (FHA) lending program has made some changes to adapt to current market conditions, its policies, practices and procedures remains significantly different from those of the conventional mortgage lending market, and those differences create clear obstacles to use of the program.

The FHA was developed to broaden home ownership in the United States following the Great Depression and could return to playing a significant role to that end by providing an alternative to the subprime mortgage market, among others. However, differences between originating FHA mortgages and originating “conventional” mortgages have persisted to the detriment of the FHA. Because there are severe penalties for FHA mortgagees that do not comply fully with FHA’s outmoded rules (regardless of the quality of the loans that are originated for FHA insurance),<sup>1</sup> and because of the high cost of being required to run a parallel, and significantly different, loan underwriting process, many responsible lenders are either exiting the FHA market or minimizing their involvement with it. Consequently, FHA loans constitute a small and shrinking part of the market. In making the recommendations set forth in this paper, it should be recognized that adapting FHA policies to conventional rules must not eliminate the unique benefits offered by the FHA program, which in some respects add flexibility to the market.

The FHA’s shrinking market share prevents it from serving its intended purpose to expand home ownership, particularly for first time home buyers. As concern over delinquency and foreclosure rates increases, some have also seen the FHA program as a possible source of aid to distressed borrowers.<sup>2</sup> Unfortunately, FHA’s policies, practices and procedures unnecessarily limit the borrowers who can qualify for FHA loans. To make the FHA program more accessible, its policies, processes and procedures must be updated to more closely resemble conventional lending programs. Unless FHA can articulate a reason why conforming its policies and procedures to conventional mortgage practices would not advance its federal housing policy goals, FHA should amend its rules to conform to conventional mortgage rules.

#### **Enacting Section 203(y) Would Make the FHA Program More Accessible to Both Borrowers and Lenders**

The changes, as well as many other helpful changes, would be accomplished by amending Section 203 of the National Housing Act to include the proposed subsection (y), attached hereto, which would require FHA to adopt “processes, procedures and policies that conform with those

<sup>1</sup> See, e.g., Dawn Kopecki, *ABN AMRO Signs \$41 Million Settlement With HUD, Justice*, DOW JONES NEWSPAPER, Jan. 4, 2006 (describing severe penalty for relatively minor procedural infractions).

<sup>2</sup> See, e.g., Kenneth R. Harney, *FHA Comes to the Rescue of the Credit-Challenged*, WASH. POST, Mar. 17, 2007, at F01.

customarily used by other secondary market purchasers of residential mortgage loans” unless the Secretary (1) determines that the extrinsic secondary market rules would not advance federal housing policy goals, and then (2) identifies for FHA mortgagees the rules it is not adopting, the rules it is putting into place instead, and the reason for its determination. This would enable would allow the Secretary to depart from standard market practice when warranted by the unique mission of FHA, yet would minimize unnecessary and unjustifiable differences.

#### **Examples of Significant Differences Between FHA and Conventional Lending Programs**

While conforming the FHA program to conventional mortgage rules would require many changes, some quite technical, the following are a few examples of some potential changes that could enable more borrowers to qualify for FHA loans and simultaneously make it easier for lenders to offer FHA loans.

*FHA should simplify its down payment requirement.*

FHA requires borrowers generally to make a down payment of 3% of the value of the property, which can be complicated depending upon the circumstances of financing. The calculation includes a tiered system of down payment requirement based on loan amount and location-specific closing cost levels. In contrast, where conventional loan programs have a down payment requirement, they have a much simpler calculation mechanism.

*FHA should eliminate the requirement that appraisals be performed by FHA panel appraisers.*

Since FHA now uses Fannie Mae forms for appraisals, the requirement that appraisals be performed by FHA panel appraisers makes little sense. Elimination of this requirement would allow lenders to move transactions seamlessly between FHA and conventional programs, reducing delays and expense to consumers. FHA should also allow the use of automated valuation methodologies that have been effectively used in the conventional mortgage market.

*FHA should eliminate the Mortgage Credit Analysis Worksheet (MCAW).*

Instead of requiring use of the MCAW, FHA should allow use of the loan transmittal summary (form 1008) used by conventional lending programs.

*FHA should use similar criteria for evaluating creditworthiness.*

FHA currently uses a very different method of evaluating the creditworthiness of borrowers than is used in the rest of the conventional mortgage market. Instead of basing decisions on FICO, FHA currently uses a “total scorecard” method for evaluating potential borrowers. The FHA method differs substantially from the method used by lenders in conventional programs, and is a significant hurdle in lenders ability to incorporate FHA loans into their other conventional loan programs. To retain maximum flexibility, lenders should be permitted to use either the conventional approach or FHA’s current method.

*FHA condo review/approval process should mirror the review/approval process of conventional programs.*

FHA's policies and procedures for reviewing and approving loans secured by condominiums require large amounts of time and involve a burdensome documentation process—neither of which is required by conventional lending programs. If the FHA process mirrored the conventional program process, the responsibility for Condo approval would be shifted to the lender and would allow HUD to reallocate resources used to approve projects and maintain approved condo lists to areas that could drive greater FHA market share.

*FHA should treat fees as they are treated in conventional programs.*

FHA's current cap on fees and requirements for combining fees differs significantly from conventional lending programs. FHA's treatment of fees should be changed to correspond to the conventional treatment of fees.

*Servicing and Default Management*

Additionally, FHA's procedures for loan servicing and default management should be scrutinized for any unjustified differences with conventional practices. Some lenders, including particularly small mortgage companies that do not service their own loans, have suffered extensive losses where HUD's indemnification procedures allowed excessive management fees to accumulate on foreclosed properties. This eliminated any possibility of realizing on the equity in the home and resulted in unexpected and severe liability on the unsuspecting lender. This agency-mandated process that can lead to unchecked liability does not exist in the conventional market. These processes and all those in HUD's single-family program, should be reviewed and conformed to conventional practices, except where the FHA makes an express determination that such a change would unduly expose it to risk or would be otherwise inconsistent with its objectives under the National Housing Act.

\* \* \*

While these are only a few examples, the FHA procedures and regulations governing FHA loan origination are extensive and exacting. As noted, non-compliance with these rules can lead to severe penalties and losses. It is clear that part of the reason for FHA's shrinking market share is the difficulty of compliance and the potential exposure from an after-the-fact determination by HUD that a compliance error—even a hyper-technical error—occurred. Moreover, the amount of the penalty often is out of proportion to the real consequence of the violation.

The proposed Section 203(y) attached hereto would address these issues, and many more, by making FHA consistent with conventional lending practices while allowing FHA to deviate from conventional practices to the extent warranted by FHA's unique mission. This increased conformity will make FHA more accessible to borrowers and lenders alike, benefiting both.

The CMC appreciates the opportunity to submit its testimony on issues relating to the modernization of FHA.

**Contact: Anne C. Canfield**  
**Executive Director**  
**Consumer Mortgage Coalition**  
**101 Constitution Ave., NW, 9th Floor West**  
**Washington, DC 20001**  
**Telephone: (202) 742-4366**  
**Fax: (202) 403-3926**

## ATTACHMENT A

## Proposed Section 203(y)

## TITLE II – MORTGAGE INSURANCE

## INSURANCE OF MORTGAGES

UPDATING FHA PROCEDURES

After SEC. 203 (x), add the following new subsection:

(y) Notwithstanding any other provision of this section or any other section of this subchapter, the Secretary shall, in establishing processes, procedures and policies for mortgagees to follow in connection with the originating, insuring, and servicing of mortgages to be insured under this section, use to the greatest extent practicable processes, procedures and policies that conform with those customarily used by other secondary market purchasers of residential mortgage loans not insured under this section. The Secretary may adopt handbooks and other statements consistent with the foregoing sentence to keep such processes, procedures and policies up to date with developments in the mortgage market, including, without limitation, handbooks and other statements that incorporate policies, procedures and practices of such other mortgage purchasers as the Secretary may determine by reference. Where the Secretary shall determine that the adoption by reference of the processes, procedures and policies of other mortgage purchasers would not meet the policy goals of this Act or such other federal laws as the Secretary shall determine relevant to the origination, insuring and servicing of mortgages insured under this section, the Secretary shall identify such processes, policies and procedures of the other mortgage purchasers that do not apply and publish a notice to mortgagees approved to originate and service mortgage loans to be insured under this section of such determination, the special rules adopted for loans to be insured under this section in lieu thereof, and the reasons for the Secretary's determination. A mortgagee participating in the Secretary's direct endorsement program may submit its own processes, procedures and policies for a determination by the Secretary that such are acceptable for use in connection with mortgages to be insured under this section. The Secretary shall periodically audit, through program staff, the activities of a mortgagee that has received such a determination, and activities found consistent with the approved policies, processes and policies shall be deemed to be in compliance with this subchapter. The Secretary shall submit a report to Congress within 6 months of the enactment of this subsection on the implementation of this subsection.

**Explanation:**

Federal Housing Administration mortgage loan origination, insuring, and servicing policies, practices and procedures have become outdated despite a decade long process at the FHA to update the same. The differences between originating FHA mortgages and conventional mortgages have become very significant. Because there are severe penalties for FHA

mortgagees that do not comply fully with FHA's outdated rules (regardless of the quality of the loans that are originated for FHA insurance), and because of the high cost of being required to run a parallel, outdated loan underwriting process for a shrinking part of the market, many responsible lenders are either exiting the FHA market or minimizing their involvement with it.

This amendment would require the FHA to adopt the rules of other significant secondary market purchasers (potentially including the GSEs, as appropriate) which will allow FHA to swiftly bring its policies in line with the rest of the market. The amendment contains an exception that allows the FHA not to adopt certain secondary market rules when the Secretary (i) determines that the extrinsic secondary market rules would not advance federal housing policy goals, and then (ii) identifies for FHA mortgagees the rules it is not adopting, the rules it is putting into place instead, and the reason for its determination.

This amendment would also allow direct endorsement lenders to submit their own mortgage origination, insuring, and servicing policies and procedures to HUD for approval. If HUD determines that such policies and procedures are acceptable, they would be deemed to comply with HUD requirements. FHA program staff would audit the lenders that have received such approval to ensure the lender's activities are consistent with the approved policies and procedures. This is important because there are often inconsistent interpretations of HUD's requirements by FHA program staff and HUD's IG staff, and it is very burdensome and frustrating to be subjected to differing oversight auditors when originating FHA loans.

A report will be due to Congress within 6 months of the Secretary's implementation of this provision.



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**Pat Vredevoogd Combs, ABR, CRS, GRI, PMN**  
*President*

April 9, 2007

The Honorable Alphonso Jackson  
Secretary  
U.S. Department of Housing and Urban Development  
451 7th Street S.W.,  
Washington, DC 20410

Dear Secretary Jackson:

On behalf of more than 1.35 million members of the National Association of REALTORS® (NAR), I am writing to suggest regulatory changes to the FHA program to help families keep their homes in light of the decline of the subprime market and impending interest rate adjustments affecting numerous borrowers in both the subprime and Alt-A markets.

As you know, many homeowners are facing drastic increases in their mortgage payments in the coming 24 months. We believe with some minor regulatory adjustments to the FHA program, a significant subset of these borrowers could safely refinance into an FHA mortgage and avoid foreclosure or other hardships.

Specifically, we believe that where prudent, FHA should waive requirements that a homeowner's mortgage be "current" in order to refinance into a more prudent FHA product. Many homeowners who were able to make timely payments under the original terms of their loan are finding it difficult to make payments after rate adjustments. This is occurring and will continue to occur across a wide spectrum of ARM products including 2/28 and 3/27 products issued over the past few years. Many of these homeowners that would otherwise qualify for FHA insured mortgages will be preempted by guidelines that prohibit refinance when loans are not current and will eventually be subject to foreclosure. We believe FHA can design a mechanism where creditworthy borrowers could refinance subject to prudent guidelines and avoid losing their homes.

NAR has previewed this idea to several lenders who are willing to seriously consider this program in order to avoid costly foreclosure proceedings. This would not be a bailout for lenders since they would incur significant losses. Instead, such a vehicle would help prevent a number of Americans from losing their homes to foreclosure. NAR believes in a strong FHA and would support efforts to ensure that only borrowers who truly have the capacity to repay receive the opportunity to refinance under such changes.

Finally, NAR encourages the Department of Housing and Urban Development and the FHA to undertake a robust public education campaign to promote foreclosure prevention including raising awareness of existing FHA and HUD programs. We believe that many borrowers facing rate adjustments can prevent defaults by seeking to refinance into FHA. Many are just not aware of their options. NAR pledges to be a partner in such efforts and has already demonstrated its commitment by producing an FHA education brochure with FHA and HUD as partners. Together, we have distributed over 50,000 copies across the nation. Furthermore, NAR continues to educate its members and the public on the full spectrum of

mortgage products and in ways to avoid predatory lending as part of our broader efforts to encourage financial literacy. We believe this is just the beginning. Working with HUD, our 1.35 million REALTORS® and others in the housing industry can play a valuable role in not only helping Americans achieve the American Dream but keep it as well.

Thank you for your time and consideration. If I may be of any assistance to you, please do not hesitate to contact me or our Regulatory Policy Representative, Ken Trepeta, at (202) 383-1294 or [ktrepeta@realtors.org](mailto:ktrepeta@realtors.org).

Yours Truly,

A handwritten signature in black ink that reads "Pat V. Combs". The signature is written in a cursive, flowing style.

Pat Vredevoogd Combs, ABR, CRS, GRI, PMN  
2007 President, National Association of REALTORS®

April 18, 2007

The Honorable Maxine Waters  
Chairwoman, Subcommittee on Housing and Community Opportunity  
United States House of Representatives  
Washington, DC 20515

Dear Madam Chairwoman:

On behalf of the National Council of State Housing Agencies (NCSHA) and the state Housing Finance Agencies (HFAs) it represents, we applaud you for sponsoring the Expanding American Homeownership Act of 2007, H.R. 1852. NCSHA supports Federal Housing Administration (FHA) single-family mortgage insurance program reform and urges you to enact legislation modernizing the FHA as soon as possible.

Since 1934, FHA's single-family insurance program has helped more than 30 million families obtain home mortgages. FHA-insured mortgages are used most often by first-time home buyers, low- and moderate-income buyers, minority buyers, and buyers who cannot qualify for conventional mortgages.

FHA's single-family program is self-sustaining, operating at no cost to American taxpayers. Independent audits show FHA's capital ratio—the primary indicator of the program's financial health—exceeds congressionally mandated standards and is likely to continue to into the future. Allowing FHA to serve a larger portion of the affordable housing market will further strengthen its actuarial soundness by enabling it to build an even higher-quality, more diverse loan portfolio.

FHA is essential to the success of the Mortgage Revenue Bond (MRB) first-time home buyer program, which HFAs operate in every state. MRBs have made first-time homeownership possible for 2.6 million low- and moderate-income families. Another 100,000 families each year become homeowners with the help of MRB mortgages.

The MRB program relies heavily on FHA single-family mortgage insurance. In 2005, 44 percent of all MRB loans financed by state HFAs were insured by FHA. In some states, including Mississippi, Texas, and Utah, more than 85 percent of state HFA-financed MRB loans in 2005 were FHA-insured.

MRB borrowers commonly use FHA insurance for several reasons. FHA insurance is frequently less expensive for the borrower than private mortgage insurance. FHA underwriting terms often allow borrowers to obtain mortgages they could not acquire with conventional products. In addition, bond rating agencies view bonds backed by FHA-insured mortgages as more secure because of FHA's federal guarantee. HFAs utilizing FHA insurance may receive

higher bond ratings and maintain a lower loan loss reserve than they would without FHA insurance.

However, the percentage of FHA-insured MRB loans is dropping rapidly. Five years ago, 58 percent of state HFA MRB loans were FHA-insured. Ten years ago, 60 percent were FHA-insured.

The reasons for this decline are complex and vary from state to state, but the most significant reason is FHA's inability to keep up with innovations and changes in the mortgage marketplace. As lenders have developed new products that have attracted borrowers and transformed industry standards, FHA has not been able to respond in kind. Widespread risk-based premium pricing in the conventional market has allowed low-risk borrowers to buy their homes more affordably with conventional loans.

FHA down payment requirements used to be generally lower than those in the conventional market, but that is no longer the case. FHA used to be the best, and sometimes the only, option for prospective homebuyers with low credit scores. To an increasing extent over the last several years—until just recently—those borrowers had many other options. Many of them still do, despite tightening subprime standards.

In addition, out-of-date maximum loan limits have made loans in high-cost areas ineligible for FHA insurance.

H.R. 1852 and other FHA modernization proposals would increase FHA's loan limits and authorize it to offer more flexible products and base premiums on borrower risk. These changes would allow FHA to respond to market innovations, regain market share, and strengthen its financial position. Modernization would also allow FHA to offer subprime borrowers and other borrowers with problematic nontraditional or "exotic" mortgages increased access to refinancing and home purchase options more suitable to their financial circumstances.

Thank you for supporting this important and timely legislation. We look forward to working with you to enact FHA modernization as soon as possible.

Sincerely,

Barbara J. Thompson  
Executive Director