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LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS, AND GNMA IN THE SINGLE- AND MULTI-FAMILY MORTGAGE MARKETS, PART 2

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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LEGISLATIVE PROPOSALS TO DETERMINE THE FUTURE ROLE OF FHA, RHS, AND GNMA IN THE SINGLE- AND MULTI-FAMILY MORTGAGE MARKETS, PART 2

Thursday, September 8, 2011

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

The subcommittee met, pursuant to notice, at 2:14 p.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Capito, Garrett, Dold; Gutierrez, Waters, Cleaver, and Sherman.

Ex officio present: Representative Frank.

Also present: Representatives Hinojosa and Green.

Chairwoman BIGGERT. This hearing of the Financial Services Committee's Subcommittee on Insurance, Housing and Community Opportunity will come to order. We are going to start with two opening statements from the chairman and the ranking member, and then have our first witness. And then we will come back to anybody else on the committee who would like to make an opening statement.

Thank you all for your patience. Those pesky votes sometimes get in the way of moving forward on time.

With that, I will yield myself time for an opening statement.

I would like to welcome everybody here today. Today we continue our work as part of a broader initiative that the Committee on Financial Services is undertaking, a comprehensive review of the mortgage finance system, including the secondary markets in the public and private sector.

Combined, FHA, Fannie Mae, and Freddie Mac monopolize well over 90 percent of the mortgage market. The private sector can't compete with the taxpayer-backed government housing programs. We must allow the private sector to capture as much of the mortgage market as possible, and the only way to do that is to phase out the government and taxpayer-backed capital to allow private capital to return.

Today's hearing is the second in a series—the first hearing was held on May 25, 2011 [Serial No. 112–32]—and we will again examine legislative proposals to help stabilize the housing market, facilitate the return of private capital to housing finance, and reduce

taxpayers' liabilities. These proposals are a starting point for our continued constructive dialogue about the future role of the FHA, our Federal Housing Administration; the RHS, the Rural Housing Service; and Ginnie Mae in the single- and multiple-family mortgage markets. This hearing offers Administration officials an opportunity to weigh in on our reforms. It also offers the Administration a chance to provide input on the future roles of FHA, RHS, and Ginnie Mae; how best to ensure their financial soundness and wind down their government involvement in the mortgage market, while increasing private-sector participation. I guess I have said that an awful lot.

Additionally, we have asked the Administration to comment on H.R. 2573, a bill introduced by Representative Hinojosa to reauthorize an expired program that allows FHA to provide Federal mortgage loan insurance to finance health care facilities. Does this program pose any risk to taxpayers? And are there private-sector alternatives?

Finally, along with our panel of two witnesses, we have invited a special guest from the upper Chamber today, or as we sometimes call it the "House of Lords." Senator Johnny Isakson of Georgia is here to discuss his views on the impact of the Administration's March 31st proposed risk retention rule, specifically the Qualified Residential Mortgage, or QRM. As proposed, these rules could distort competition in the housing market, limit the availability of credit, raise costs for consumers, add uncertainty, and cost jobs. In addition, they could actually increase the market share of FHA and the GSEs, which would move us 180 degrees in the wrong direction.

Private-sector businesses need regulatory relief, certainty, and common sense, not unfair competition from Washington. And Americans need jobs, which is what businesses, not governments, create. The bottom line is that the government needs to get out of the housing business, let the private sector return, and allow the free market to work. Housing typically leads us out of recession, so we must get this right.

With that, I recognize Ranking Member Gutierrez for his opening statement.

Mr. GUTIERREZ. Good afternoon, and thank you, Chairwoman Biggert, for holding this hearing. I would like to welcome our witnesses, especially the Senator, and thank them for being here today as we continue to discuss the role these agencies play in our Nation's housing.

When the subcommittee convened on the same subject in May, we received feedback from industry representatives that I suspect will be echoed in the testimony we hear today. First, that hearing highlighted the fact that our communities continue to struggle, and that the housing market remains particularly fragile. Second, the witnesses acknowledged that government housing programs have played a critical, stabilizing role by providing access to loans for creditworthy borrowers. The agencies represented here today have prevented the housing crisis from spiraling out of control, and done so while managing risk to the American taxpayer. Third, we heard loud and clear that any additional proposals intended to reduce FHA's footprint in the housing market must be carefully considered

and be incremental. Otherwise, we risk causing additional disruption at a time of continued economic instability.

I would like to note that Congresswoman Waters reintroduced the FHA reform bill in July, a bill that makes it easier for FHA to go after bad lenders, strengthens oversight for the single-family program, and raises FHA multifamily loan limits in very high-cost areas. This is substantially the same FHA reform bill that passed this committee and the House of Representatives with broad bipartisan support a little over a year ago.

The discussion draft that we are considering again today contains some of those bipartisan provisions, but it has several others that I am concerned will limit access to homeownership at a time when the housing market is still struggling. The proposal to increase the downpayment requirement from 3.5 to 5 percent could effectively cut cash-strapped individuals out of the housing market. I have to tell everyone that it kind of feels like "Groundhog Day" on this issue, because we have seen it before. A similar amendment was struck down in this very committee by a vote of 52–12 and failed substantially when it was raised in the House of Representatives.

The draft also substantially reduces FHA loan limits and sets new county-by-county limits. In the State of Illinois, we have probably a couple dozen counties. This change would be an added administrative burden to FHA and would make it more difficult for small lenders to offer FHA loans in their communities. That sounds a lot like the kind of unnecessary government regulation that stifles business and economic growth that my Republican colleagues often condemn. County by county. Every bank is going to have to figure it out. More government regulation.

Even more importantly, the change will make homeownership more expensive for families across the Nation. A reduction in loan limits is already scheduled, and it is simply too risky to implement further reductions at this time.

Finally, I am concerned that moving the Rural Housing Service under the authority of the FHA will prove expensive to implement, will lead to minimum gains in efficiency, and could result in less attention to rural housing needs. A large-scale reorganization like the one proposed would be extremely disruptive to both agencies at this time. Why are we spending more money to create more government agencies? Let us keep it the way it is until we can implement some of the other aspects of this.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you, Mr. Gutierrez.

Now, we will turn to our first panel. And then after that, we will have the remainder of the opening statements. I would like to welcome Senator Johnny Isakson of Georgia. It is nice to see you back in this Chamber.

Senator ISAKSON. It is good to be home again.

Chairwoman BIGGERT. That is good.

So with that, I recognize you for 5 minutes for your statement.

STATEMENT OF THE HONORABLE JOHNNY ISAKSON, A UNITED STATES SENATOR FROM THE STATE OF GEORGIA

Senator ISAKSON. Chairwoman Biggert, Ranking Member Gutierrez, and other members of the subcommittee, thank you very much for having me testify before this very important subcommittee on the very important investigation that you are doing. You have my written statement, which I will not read. I will try and emphasize what I think is so important on the QRM issue, the housing market, and mortgage credit in this country.

Chairwoman BIGGERT. Let me just say that without objection, your written statement will be made a part of the record.

Senator ISAKSON. Thank you, Madam Chairwoman.

For reference only, let me give you my life experience in single-family housing. I spent 33 years, 11 of them as a salesman and sales manager for a real estate company, and 20 of them running that real estate company. In the latter years of my service, before I came to Congress, we averaged selling more than 10,000 single-family homes a year in metropolitan Atlanta and utilized every type of conventional financing, as well as FHA, VA, and securitized loans.

During that career I went through 4 housing recessions: 1968; 1974; 1981–1982; and 1990–1991. They were all devastating, but nothing anywhere close to the pervasive devastation of the current crisis. And what you are looking at is going to be important to the recovery of the housing market.

When the Dodd-Frank bill came before the United States Senate, and the 5 percent risk retention proposal on mortgages was made, I got involved with Mary Landrieu, Kay Hagan, and other Members of the Senate to develop what became known as the Qualified Residential Mortgage rule to the Dodd-Frank bill. It was intended to create an exception for risk retention. And this is critically important in the entire testimony. The Dodd-Frank bill eliminates from risk retention Freddie, Fannie, and FHA, but any other lender would be required to hold 5 percent risk retention in a residential mortgage that it made. Five percent risk retention is a tremendous burden that very few people could actually meet.

So we put in the Qualified Residential Mortgage to address the crisis that was caused in 2007. We did not have a downpayment recession; we had an underwriting recession. Rules became loosey-goosey; people made mortgages to folks as long as they could fog up a mirror. They didn't check their qualifications, they didn't appraise the houses, they didn't check their income ratios, and we made bad loans. They became securitized and sold. And, in fact, partially because of congressional delegation, Freddie and Fannie owned a portfolio of those loans which began the crisis that started in September 2008 when they all collapsed.

So our intention was to ensure in the bill that you could exempt from risk retention any loan made that met the Qualified Residential Mortgage standards, which meant: good ratios of debt to monthly payment or income to monthly payment; a credit report that demonstrated you could make the payments that you would end up having to pay; a background check that included third-party verification of your employment, credit run and appraisals made; and all the normal underwriting we saw for years and years. With

that done, you could exempt yourself from the 5 percent risk retention, which would attract tremendous private capital into the residential mortgage market.

Unfortunately, when the rule got to the FDIC, the Comptroller of the Currency and the others on the committee writing the rule published that the chairman referenced in March added to those requirements a minimum 20 percent down to avoid risk retention. And that is what I am here to really emphasize today.

Beginning with 1967's creation of the 90 percent loan, and 1982's creation of the 95 percent conventional loan, during the last 45 years, the American housing market has depended in large measure on loans that were up to 95 percent loan to value, conventional loans. Those loans had additional insurance on the amount of the loan above 80 percent called private mortgage insurance, which was double underwriting and double security for the lender, so their principal risk was 80 percent of the purchase price, the same difference you would have if you required a 20 percent cash downpayment and made an 80 percent loan.

The effect of the rule that has been circulated, and to the credit of the FDIC—Chairman Bair and others—they postponed the comment period from the end of June until the beginning of August to get more comments in about QRM. I do not know what process they are in, but 39 other Members have joined me in a letter from the Senate asking them to review the rule and remove the requirement for 20 percent down, and instead allow loans up to 95 percent of value as long as there is private mortgage insurance and credit enhancement on that amount of the debt above 80 percent.

The reason we did it is this: The consequences of the QRM rule as it is written going in place will be devastating for FHA. Because they are exempt, everybody will move to FHA because of its downpayment of 3.5 percent, and I respect the Chair's move to consider 5 percent. Whichever it is, it is a lower downpayment. As I understand it, almost 40 percent of the loans made in 2010 were by FHA, and 10 years ago, it was 2 percent. The whole marketplace has descended on them because of the evacuation of readily available credit and capital into the conventional mortgage market.

The QRM rule will impact between 40 and 50 percent of the traditional housing purchases in America and remove those people from competitiveness at a time when we need people coming back to the marketplace to stabilize values and begin to build back the U.S. housing market.

So my message to the subcommittee today, and it is the same message I have shared with the Comptroller of the Currency, Chairman Bernanke, Chairman Bair and others is that the QRM rule is a well-intended rule that has devastating consequences. It will put pressure on FHA, Freddie Mac, and Fannie Mae to the extent they can't stand it. It will reduce the flow of conventional capital into the mortgage markets. It will cause more job loss, less construction, and a more protracted housing recession. All those things I hate to predict, but they, in fact, would take place.

Madam Chairwoman, I appreciate your allowing me to comment on it, and I will be happy to respond to any questions the committee might have.

[The prepared statement of Senator Isakson can be found on page 50 of the appendix.]

Chairwoman BIGGERT. Thank you very much, Senator.

What you have had to say shows that what started out has changed dramatically because of the regulations?

Senator ISAKSON. What started out as an intention to exempt from risk retention qualified loans has turned into a definition of a qualified loan that is going to make it impossible for most Americans in the marketplace to get a loan other than through FHA, Freddie or Fannie.

Chairwoman BIGGERT. Okay. What would be the ramification if QRM remains as it is right now to those loans that are not under QRM? Would the property value change and others if they don't qualify, but they still get a mortgage? Is that going to have an effect on the actual value of the property?

Senator ISAKSON. QRM was designed as an exemption to the 5 percent risk retention.

Chairwoman BIGGERT. Right.

Senator ISAKSON. So if QRM stays the way it is, and it only applies to loans with 20 percent down or more and the other parameters written in it, then it greatly eliminates the amount of 90 and 95 percent conventional financing in the marketplace to almost zero and puts FHA in the position of carrying the full burden for the entire country. This would be a devastating load on FHA, which is already under stress.

I want to reiterate that a conventional 90 and 95 percent underwritten loan requiring private mortgage insurance to insure the amount of the loan above 80 percent would be just as competitive as a 20 percent down loan with no private mortgage insurance requirement, which is what the QRM rule is trying to promote. So the net effect is going to be a great restriction in the available conventional money for 90 and 95 percent loans in the marketplace. And the few people who will make them will price them high because they control the marketplace, which ends up hurting the consumer as well.

Chairwoman BIGGERT. So it decreases competition?

Senator ISAKSON. From a lending standpoint, it does. Already, in anticipation of this rule going into effect, private mortgage insurance companies have closed. Most mortgage brokers in the marketplace are not operating. There has already been a devastating effect on the mortgage industry just because of the anticipation of this rule. And it will be even worse on the overall housing industry if it goes into effect as it is written.

Chairwoman BIGGERT. Can you estimate how many jobs would be lost from that?

Senator ISAKSON. No. I know when to stop guessing at things, and I would not want to guess at something like that.

Let me just say this: We will never get our job market back until construction comes back. The City of Atlanta, in my State of Georgia, has 10.2 percent unemployment, about 1.1 percent higher than the rest of the country, principally because we were a major southeastern Sunbelt growth State with a lot of construction. Those jobs are gone, and they are not going to come back until residential housing comes back. And we are never going to get below 8 percent

in unemployment until we do return the construction industry to some sense of viability. That is not a chicken-or-egg question; it is residential housing first, and then it is commercial properties and apartments second.

Chairwoman BIGGERT. Thank you very much.

I would you like to recognize the ranking member of the full committee, Mr. Frank, for 5 minutes.

Mr. FRANK. Thank you. I appreciate it. This is a very important conversation to have. And I agreed that 20 percent was too high, but we have some disagreements that I wanted to talk about.

First, as one of those who helped write the bill, I differ with the Senator's interpretation of the purpose. I thought risk retention was very important, and I wanted it to be the rule, not the exception.

I just finished reading Michael Lewis' "The Big Short" and Gillian Tett's "Fool's Gold." I don't think there is much question but that the ability to make loans and not have to pay a penalty if they went bad was an enormous contributor to this. And I guess I have a couple of questions. First, Senator, you mentioned mortgage insurance. My problem with mortgage insurance is it is there if the loan goes bad, but for that very reason it is not a deterrent to making loans that shouldn't be made. The mortgage insurance would hold you harmless. So I don't understand how mortgage insurance—I understand the purpose of mortgage insurance in some ways, but I don't see it as a substitute for risk retention. How is mortgage insurance a deterrent for the lender making bad loans?

Senator ISAKSON. Let me apologize at the outset. I didn't realize you had snuck in. I certainly would have recognized you when I recognized—

Mr. FRANK. I wouldn't say that I snuck in, Senator. I thought I kind of walked in.

Senator ISAKSON. Quietly came in.

That is an excellent question, and it allows me to elaborate on something, a point I do want to make. When I first did 90 and 95 percent loans as a residential salesman in the 1960s and 1970s, you had dual underwriting. You had the principal underwriting by the lender that loaned 80 percent, or in some cases 75 percent, and then the 90 percent became a piggyback second mortgage, if you will, made by somebody like Mortgage Guaranty Insurance Corporation, or PMI, or somebody like that. So you had dual underwriting. You had the principal lender making the first loan of 75 to 80 percent of value, did their underwriting, and then the PMI company came in, and in return for their guarantee and a fee they received, they underwrote the loan as well. In fact, initially there were even rate differentials on the piggyback loan over the principal loan. So you had double underwriting, or a redundant underwriting system.

Secondly, the principal lender, their risk on the loan was 80 percent or 75 percent of the value of the house, not 90 or 95, because the insurance was on that amount above 75 or 80 percent. That worked really well until we got into the mid-2000s, when stated income, and Alt-A, and windshield appraisals, and zero downpayment, and all the other stuff came in, and Wall Street securitized or sold securities to raise the capital to make these loans to prin-

cipally people who really weren't either prepared or qualified to make them, which is why I say, and this is—

Mr. FRANK. But, Senator, the point is that mortgage insurance didn't deter that then. Why would it deter it now?

Senator ISAKSON. I am sorry?

Mr. FRANK. The fact is that mortgage insurance did not deter that, because it did not deter the lenders from making the loans that they shouldn't have made because they would be held harmless.

Senator ISAKSON. First of all, in the QRM amendment which we placed in the Senate, it put in principles of underwriting that had to be met.

Mr. FRANK. I agree with that.

Senator ISAKSON. Hold on a second. What happened with the collapse of the mortgage market or the housing market was no underwriting at all. There was none whatsoever. And that is what took place.

Mr. FRANK. I understand that.

I don't want to prolong this. I just want to make two points. First of all, I disagree that risk retention is as heavy a burden as many have argued it. If the ability to securitize with no risk retention is essential to the housing market, I have to wonder where people were living before the 1990s. Because, of course, securitization of mortgages is a very recent phenomenon of the 1990s. People used to not be able to securitize. They had 100 risk retention, and a pretty good housing market, as you indicated during that period when you were there.

Second, with regard to mortgage insurance, this is my point, I understand these problems. My point is that mortgage insurance is not a sufficient deterrent because the lender is held harmless.

And the final point I would make is this, and I think it is an odd argument for me to be having with some of my conservative friends. Yes, we wrote those standards in. Those standards are dependent on regulators enforcing them. Those standards are, of course, not self-executing. And I agree we want to have standards, and the regulators didn't do enough.

One of the things I think we agreed on bipartisanly was—and I know you would agree that many of the loans were being made by people who were outside of the regulatory structure because they were nonbanks. And if only banks had made the loans, we wouldn't have been in as much trouble. So, we have extended a set of rules to nonbanks.

The problem, though, is that I don't want to rely wholly on the regulators. I think the thing about risk retention is it is a market incentive to the lender itself. So my concern is that I don't think we should put too much on the lender.

Finally, let me say this, and I agree, I agreed with legislation that was brought forward by the Majority to make it explicit that Fannie and Freddie would be covered by risk retention. And I had this argument back and forth. I am now ready to find ways to cover FHA. I do think that distinction is a problem. The downpayment issue can be dealt with. But, yes, I think it is a good argument. I am for a strong risk retention requirement, and probably including FHA.

Chairwoman BIGGERT. The gentleman's time has expired. Would you like to respond?

Senator ISAKSON. If I could, please. We have a lot of areas of agreement. And I want to acknowledge, first of all, your statement in July following my statement on the Senate Floor regarding the QRM rule as it was being circulated, because I think we both share some common feelings about that. Your reference to the savings and loans and their housing market did fine before securitization, as you probably will remember, it was the change of a Federal rule on S&Ls that caused the ultimate collapse of them and the housing market. When we took away their interest preference over banks in terms of what they could pay on deposits, it dried up all their money to make loans. So they basically went out of business. And then Freddie and Fannie really burgeoned because securitization became the way that capital was created to put into mortgages in America up until the time that we also dictated and got Freddie and Fannie more in the business of holding some of those in their portfolio, which gave a purchaser of those subprime securities that were then made on Wall Street, which ultimately contributed to the problem.

So I fully agree with you that there are concerns, but I would tell you this: Quality underwriting makes good loans, and historically that has always been true.

Mr. FRANK. Can you depend on the regulator to enforce those? My problem is I don't want to depend entirely on the regulator. I want the lender to have more incentive than they would otherwise have to make those kind of loans.

Senator ISAKSON. That is why we wrote those criteria in QRM, because we did think there should be a standard if risk retention was waived so you didn't just make a loosey-goosey loan or a poorly underwritten loan.

Mr. FRANK. Thank you. I will try to sneak out now.

Chairwoman BIGGERT. The gentleman from Virginia.

Mr. HURT. Thank you, Madam Chairwoman.

Thank you, Senator, for speaking to us this afternoon. And I appreciate it in the context especially of sort of the backdrop of what I think that most people here in Washington would like to see, and that is a winding down of Fannie Mae and Freddie Mac, and also in the context of jobs. I would like to hear from you your thoughts on the big picture of how we entice the private sector into the secondary mortgage market. I think that is something that is obviously the big struggle that we are facing now for those of us who would like to see Fannie Mae and Freddie Mac diminished.

And the second thing that I would like you to speak to, if you would, is as it relates to what you said about the jobs picture in your State of Georgia. How do we do it in a way that takes into account the fact that we don't want to put any additional burdens on the home-building sector? We don't want to put additional burdens, unnecessary burdens on the real estate sector. So how do we do this in an intelligent way and a careful way so as to wind those institutions down, but at the same time do it in a way that doesn't prolong this stalled economic recovery?

Senator ISAKSON. Let me thank you for the question. And both of those are right on point.

I am deeply disappointed about the failure of Freddie and Fannie, as everybody is. And the implied government sponsorship obviously became a government obligation and cost this country a great deal of money. I am going to have a conversation in a little bit with the head of HUD on this very subject in terms of opinions, discussions that we might have.

There is a role for a Freddie or a Fannie, but it is much different than the role it has right now. FHA, Freddie, and Fannie are the housing market in terms of mortgages in this country principally right now, and an implied government sponsorship that is reduced over time or amortized over time probably is the best way to bridge from where we are to where we need to be.

I have said publicly that if you took the Pool Re concept, which is a concept in Europe where you put a premium fee on each closing, say, 50 basis points or 100 basis points, and that goes into a walled-off sinking fund over 10 years' bills to be the backdrop and collateral for the mortgages that are made where you become self-insured rather than backed by the full faith and credit of the taxpayers probably would be the best way to go to ensure that you have liquidity for the purchase of those loans in this country.

But there would probably be a role for a Freddie or Fannie-like institution. And, quite frankly, with regard to multi-family construction, which right now is the only construction in the United States, if it weren't for Fannie Mae and Freddie Mac, there wouldn't be any multi-family construction. So you are going to have to find a way to attract that capital in the marketplace, or you are not going to have enough liquidity in it to bring the housing market back, either multi-family or single-family.

I think the one message that—again, I gave this speech in the Senate a few months ago, the unintended consequence of well-intended regulators. The big wet blanket that exists over housing construction, real estate development, and all the component parts are what—the next shoe dropping from a regulatory standpoint.

I think we need to move as expeditiously as we can to take things like the QRM rule, get it straight so it works. If it accomplishes what the former chairman said in terms of insuring, you have better underwritten, better qualified loans, but we have some sense of predictability. I personally would guess, and I haven't talked to them, but I think FHA would like a little relief from the pressure it is under right now as being the only act in town for a substantial number of the mortgages made in the United States. This is my opinion now that I am stating. Government's role is to mitigate risk, but right now it looks like everybody's job is to eliminate risk. And if you eliminate risk, you eliminate free enterprise and capital formation and all the things we need to come back in this country.

So I think we need to measure the effect of regulations, be sure we have those regulations that are in place to protect the consumer and ensure a fair and a level playing field, but not so proscriptive as the proposed QRM rule that it actually drives capital away from the housing market at a time it has very little capital coming to it as it is.

Chairwoman BIGGERT. Mr. Gutierrez?

Mr. GUTIERREZ. Thank you.

Chairwoman BIGGERT. You are recognized for 5 minutes.

Mr. GUTIERREZ. Okay. So I want to thank you again, Senator, for your testimony. And I agree that the Qualified Residential Mortgage is important and will encourage a return of private capital, with quality underwriting, to the mortgage market. But the details matter. You said you think 5 percent downpayment is the right number for the QRM standard. Can you speak a little bit more about that and why 5 percent?

Senator ISAKSON. I think it is the right minimum number. I don't think any lower downpayment would be—I wouldn't—given the experiences we have seen and the history I had in the industry, except for our veterans, who have earned every bit of their 100 percent loan guarantee that they have on a VA loan, I think skin in the game is very important. I know people tend to protect that which they have an investment in, and that initial cash downpayment is important.

But I think 5 percent—all I can base it on is my experience of almost 30 years when we were doing 95 percent loans in the marketplace. It was an alternative to the FHA loan, which was a 3 or 3½ percent downpayment. And as long as the loan is underwritten to demonstrate the borrower can make the payments, has a credit rating that shows they are responsible, the house is appraised, and you have third-party verification of employment and ability to pay, and you have parameters on the ratio between monthly payment and gross monthly income, you can well underwrite a loan whose downpayment, whether 20 or 5 percent, wouldn't be any different in terms of the quality of the loan.

Mr. GUTIERREZ. I just needed to ask that one. I won't use my whole 5 minutes. Thank you.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from New Jersey. Do you have any questions?

Mr. GARRETT. Maybe not so much questions, but just a comment or two. I appreciate the comment from the gentleman from Massachusetts saying that he does not feel that we should be depending upon the regulators so much in this area. Would that be the case with regard to Dodd-Frank, which, as we know, is going to promulgate over 400 new regulations, where the regulators are going to have more authority than they ever had before? I think that was the entire intention of that piece of legislation; not to let the markets be the deciding factors, but the regulators. Could we peel that back? Maybe that is a direction we should be going.

To your comment with regard to the wet blanket, I agree with you as far as it is in part the next shoe to drop that is out there as far as the market is concerned. It is also, you would probably agree with me—the wet blanket also is the fact that we have those 400 regulations coming down the pike, and the small banks having to hire all of the new compliance officers in order to comply basically with it. That certainly is a wet blanket, I think you will agree, as well.

But I do appreciate the Chair holding this important hearing today, because reforming FHA and Ginnie Mae is important to the overall fix to this problem. The fact that we are looking at over 90 percent of the U.S. mortgage market being controlled or financed by the Federal Government is an unsustainable path that we are

on right now. With debt over $14 trillion, it is one that is simply not sustainable to add an additional $10 trillion of credit risk to the Federal Government's balance sheet now. We must begin, I think you agree, to add private capital back into the mortgage market.

Now, one small step that we can do in that regard will occur at the end of this month, and that is when conforming loan limits are set to drop from 729- down to 625-. I think this is an appropriate first step in beginning to transfer the housing risk off the taxpayers' back and put it in the private sector. In the aftermath of that big debt discussion that we had last month, it is very clear the Federal Government currently has very limited resources in which to allocate to the broader public. I do not feel that subsidizing, and basically that is what we are doing here, almost million-dollar homes is the way to utilize those limited resources.

If you look at the banks out there and the broader financial conditions that they are in, the banks are basically flush right now with deposits. And they have ample room on their balance sheets to take on an additional segment of the market without, I have heard this from experts, a drastic spike in rates. And so for someone to be able to afford that $750,000 house, how much do they need to make? They basically need to make a quarter of a million dollars a year to afford that. This is the same segment of the population that my colleagues on the other side of the aisle say are the rich and that should be paying more taxes. Maybe the solution is not to tax them even more and then subsidize them on one hand; it is simply allow those people to keep their own money and basically pay for their own house, without the subsidization of the taxpayer.

I also don't think FHA was ever intended to help these higher-income individuals to buy their homes. I believe FHA should only be used to help lower-income individuals and first-time buyers. I know housing conditions are still very fragile, as the Senator has indicated, and that is why I advocate for reforms to occur over time in a responsible and appropriate manner. But we really need to begin with these first steps because it will be harder otherwise to put the market back in order.

With that, I yield back to the Chair, and I thank the Senator.

Chairwoman BIGGERT. I thank the gentleman.

And we thank you, Senator, for coming. I think that you really helped us with a lot of information. I appreciate your testimony.

Senator ISAKSON. Thank you, Madam Chairwoman. I just leave you with one—if you remember one message from what I said, the deep collapse of the housing industry in America was principally a failure of underwriting, and that is what caused the collapse and led to all the subsequent things that took place. And that is where we ought to focus to ensure loans are qualified for the future.

Chairwoman BIGGERT. Thank you so much for being here.

Senator ISAKSON. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Before we call up the next panel, I do want to mention something that is very important, and that is that Scott Olson is retiring on Friday, having served 20 years with the House of Representatives. The majority of Scott's career has been with the Financial Services Committee, working on housing and

mortgage finance issues. So we thank Scott for his service to the U.S. Congress and to this committee.

Mr. FRANK. Madam Chairwoman?

Chairwoman BIGGERT. I would yield to the ranking member.

Mr. FRANK. Madam Chairwoman, thank you first for your courtesy in sending someone to make sure I didn't sneak out prematurely. I appreciate it, because I would have been very regretful if I hadn't been able to participate. Thank you for your taking this initiative.

The greatest bargain the American people get without question, in my judgment, consists of the people who work for us here. They can have different opinions about us, but on both sides of the aisle, in our personal offices and in the committee offices, the staff here work longer hours for less pay than almost all of them would make in other contexts. And they do it because of that kind of commitment. No one has exemplified that better than Scott Olson. He has become a source of information about housing policy in all aspects: legal; economic; and social. That has been an invaluable asset. His dedication to the public interest is extraordinary. And I will miss him, this Congress will miss him. He has every right, having worked as hard as he did, to move on. I know he will still be available. And after a suitable period of purdah mandated by the ethics rules, I look forward to drawing on his advice again. But I want to join you, Madam Chairwoman, and thank you for giving us the chance to thank an extraordinary public servant.

Chairwoman BIGGERT. Thank you again.

We will now hear from the second panel, if you would take your seats at the table. With that, if we have any more opening statements, I hope that they will be short.

Mr. Hurt, do you have an opening statement? You are recognized for 1 minute.

Mr. HURT. Just briefly. Thank you, Madam Chairwoman.

Thank you for holding another important hearing in this subcommittee to discuss ways in which we can strengthen FHA, RHS, and Ginnie Mae. I appreciate your leadership on these issues and your commitment to responsible policies that will get the housing market back on the right track, which is vital to our economy in Virginia's Fifth District, my district, and across the country.

As the witness at our last hearing on the subject testified, we must take steps to encourage the private sector to return to the marketplace and reduce the risks to which taxpayers are currently exposed. The FHA's role in the mortgage market has increased to the point that it is crowding out private investment. Excessive government intervention causes consumers to behave in ways that do not adhere to market principles.

The reforms that Chairwoman Biggert proposes will take modest steps to promote the return of private capital to the housing market, while improving the effectiveness and efficiency of the housing programs that these agencies operate. With our Nation over $14.5 trillion in debt, Fifth District Virginians want Congress to closely scrutinize government programs and policies that are putting taxpayers at risk and to implement commonsense reforms to remedy these problems.

Again, I want to thank the Chair for holding this hearing today. I look forward to the testimony of our distinguished witnesses. I thank you all for coming. I look forward to your perspectives on the discussion draft before the subcommittee today.

I yield back my time.

Chairwoman BIGGERT. Thank you.

With that, I will introduce our second panel: Mrs. Carol Galante, Acting Federal Housing Administration Commissioner, and Assistant Secretary for Housing, U.S. Department of Housing and Urban Development; Ms. Tammye Trevino, Administrator, Housing and Community Facilities Programs, U.S. Department of Agriculture's Rural Development Agency; and the Honorable Ted Tozer, President, Government National Mortgage Association.

Thank you all for being here. Let me just say that, without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony. After that, we will have 5 minutes of questioning from our members.

I recognize Mrs. Galante for 5 minutes.

STATEMENT OF CAROL J. GALANTE, ACTING ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. GALANTE. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for inviting me here today. Having served as Deputy Assistant Secretary of Multifamily Programs at HUD for the last 2 years, and having recently been named Acting FHA Commissioner, I am pleased to have this opportunity to testify. As my predecessor Bob Ryan becomes Senior Advisor for Housing Finance, I, as Acting Commissioner, look forward to continuing the progress we have made under Secretary Donovan to strengthen the FHA for the future.

As you know, FHA has provided a critically important source of mortgage credit during this economic recovery, particularly for underserved communities. And I will build upon a strong foundation of reforms initiated by the Administration and continue the three fundamental priorities we have focused on since President Obama took office: first, stabilizing the housing market and assisting homeowners at risk of foreclosure; second, protecting FHA's fiscal health and strengthening risk management; and third, ensuring responsible access to credit and liquidity as we work with Congress to bring back private capital to the market and build a 21st Century housing finance system.

But, of course, the job is not over, and our housing market and economy remain fragile. That is why I am pleased to share my views today on the draft legislation. And I want to commend the subcommittee for three provisions in particular. The first is the proposal to increase access to credit by supporting small lending institutions such as community banks that participate in FHA's programs, but are not able to close FHA loans in their own names.

Second, we are pleased that the legislation would extend FHA's ability to hold all lenders to the same enforcement standard for loans that were improperly originated or in which fraud or misrepresentation were involved. FHA's current indemnification au-

thority covers those lenders responsible for 70 percent of FHA's loan volume, but the time has come to hold all underwriters to the same standards, and, with this legislation, we will.

And last, the legislation provides explicit authority to terminate lenders for poor performance in specific geographies or on a nationwide basis. Such flexibility will ensure that we can protect FHA from lenders whose poor performance put the taxpayers at risk.

I would, however, like to call your attention to several provisions that the Administration looks forward to working with you to refine. The first is the proposal to create separate capital reserve accounts for the General and Special Risk Insurance Funds through which we provide financing for the FHA multifamily and health care loan guarantee programs, among others. Even though we agree that FHA must manage risk to these portfolios with the same focus and urgency as we treat the single-family fund, FHA is concerned that the creation of new capital reserve requirements, as detailed in the discussion draft, would be unworkable because they would apply the current requirements of the MMI Fund to funds that have a very different risk characteristic and structure, and contain a mix of existing and legacy programs. And so we look forward to working with the subcommittee to determine an alternative means to increase transparency and appropriately manage the risks associated with the GI/SRI Funds.

In addition, we are particularly concerned about the legislation's proposal to increase the minimum downpayment for all FHA borrowers to 5 percent. If this had been required during the past year, 345,000 families would have been shut out of the opportunity to become homeowners. Our experience during this crisis has shown that the combination of downpayment and FICO score is a far better predictor of loan performance than either of these components alone. We believe it is essential to retain the flexibility to respond to the market and loan performance conditions with a variety of tools rather than being locked into a specific downpayment structure.

And last, while my colleague with USDA will specifically address the rural components of the draft, let me say that we are already working very closely in aligning the agency's rental programs through a White House Rental Policy Working Group that includes HUD, USDA, and Treasury. And having initiated a similar conversation on the single family side as well, we believe it makes sense to continue focusing for now on those efforts rather than contemplating any more extensive reordering of the various Federal agencies' roles in these programs as outlined in the legislation.

I look forward to working with the subcommittee to refine this legislation and to address a number of other significant issues important to the Department, one of which is the methodology used in the bill to determine loan limits, which warrants further discussion and analysis given that it appears it could dramatically lower FHA loan limits in some places. I look forward to working with you to ensure that FHA continues to fulfill its mission of supporting our housing market and economic recovery, while minimizing risk to the taxpayer, as we have done throughout Secretary Donovan's tenure.

Thank you, and I look forward to your questions.

[The prepared statement of Assistant Secretary Galante can be found on page 34 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Trevino, you are recognized for 5 minutes.

STATEMENT OF TAMMYE H. TREVINO, RURAL HOUSING SERVICES ADMINISTRATOR, RURAL HOUSING SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Ms. TREVINO. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. It is my privilege to be with you today to discuss USDA's role in supporting America's continuing need for safe, affordable housing. For over 60 years, the Rural Housing Service, part of the Department of Agriculture's Rural Development Mission Area, along with Rural Utilities Service and the Rural Business and Cooperative Service, has been working to help rural America thrive by supporting the housing needs of these communities.

Rural Development is a collaborative agency. Our programs build upon one another, ultimately creating efficiencies for the taxpayer and for the communities that we serve. As part of the Rural Development Mission Area, Rural Housing Service provides single-family homeownership programs, multifamily housing programs, housing loans and grants for repair and rehabilitation, and community programs. All are integrated into a more holistic approach of rural community and economic development.

We have exceptional staff and a network of 47 State offices and 500 area offices across the rural landscape, working closely with dedicated partners in the for-profit, nonprofit, and private sector. Our field staff deliver programs for all three agencies in the mission area. By being located in rural communities, we are able to cultivate important relationships with lenders, REALTORS®, community-based organizations, redevelopment authorities, and others.

Our efficiency is noted in the strategic centralization of a significant portion of core operations, while leveraging the community knowledge of our field structure across all programs. For example, staff delivering Rural Housing Service's Community Facilities Program to eligible municipalities, tribes, and nonprofit organizations also work with these same partners on the Rural Utilities Service's water and waste programs. The importance of our local staffers cannot be overemphasized. They know the needs of their neighbors and their rural communities and provide critical support, both effectively and efficiently.

In the wake of natural disasters, Rural Development programs have worked in concert to build communities from the ground up. No other department in the Federal family offers rural communities the range of financial services available from USDA Rural Development and staff nearby to provide the technical assistance. Utilizing a total budget authority of $1.03 billion, RHS leveraged a program level of approximately $26.3 billion in loans, loan guarantees, grants, and technical assistance in Fiscal Year 2010. Our programs are provided through the Housing Act in combination with the Consolidated Farm and Rural Development Act, or the ConAct.

Rural Housing Service is a big part of Rural Development's overall success in effective program operations. Delinquencies for Rural Development are less than 2 percent of our outstanding loan portfolio of over $150 billion. Despite doubling our borrowers' numbers over the last 2 years, RHS's direct and guaranteed loan portfolios continue to perform well, thanks in large part to our state-of-the-art call center, the Centralized Servicing Center in St. Louis, Missouri. In the interest of saving time, information about delinquencies and accomplishment in the RHS programs have been provided in written form.

While RHS and HUD share an important commitment to meet the housing needs of rural America, we believe that our mission and the delivery of our programs are different and distinctive. Rural Housing, through Rural Development, has the flexibility to respond to changing needs across the rural landscape and lead other public-sector and private-sector for-profit and nonprofit partners to invest strategically in rural people and rural places, particularly those who are traditionally underserved by conventional financial models, and at times where the private sector is unable to step in.

Rural communities have a unique set of challenges, and Rural Development is well suited to address these. As policymakers, we will look to the future of the Federal role in housing, but it is important that this discussion address the needs that are inherently rural. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, while we appreciate Congress' intent to identify duplication of services across the Federal Government, we do not support the draft proposal in its current form.

Thank you for the opportunity to be here, and I look forward to answering questions.

[The prepared statement of Administrator Trevino can be found on page 70 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Tozer, you are recognized for 5 minutes.

STATEMENT OF THEODORE "TED" TOZER, PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GINNIE MAE)

Mr. TOZER. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee.

Chairwoman BIGGERT. I don't think you have your microphone on.

Mr. TOZER. Is that better?

Chairwoman BIGGERT. Yes.

Mr. TOZER. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to appear before you today.

I have been in the housing finance industry for more than 30 years, most recently serving as senior vice president of capital markets for National City Mortgage Company, where I managed loan pricing, sales, delivery, and pipeline risk management, and where I developed a deep appreciation for Ginnie Mae—

Chairwoman BIGGERT. Could you just pull the microphone a little bit closer? Thank you.

Mr. TOZER. Okay. To appreciate Ginnie Mae as a lender. Now, as Ginnie Mae's President, my appreciation has only increased.

As you know, we remain embroiled in the worst housing crisis since the Great Depression. In response, Congress and the Administration have launched a number of efforts to stabilize our economy. Even though not every initiative was as successful as we might have hoped, as a whole these efforts have made a positive difference. Ginnie Mae has played its part, making it possible for lenders to continue to lend mortgages. As providing an outlet for the sale of government-insured products, we helped stem the tide of economic upheaval and have been an essential element of the Nation's recovery efforts. In fact, during the financial crisis Ginnie Mae has provided more than $1.2 trillion in capital for mortgages, which has financed more than 4.4 million single-family homes and nearly half a million multi-family units.

We have weathered this crisis without requesting any support from the U.S. taxpayer. Indeed, our financial condition is strong. From 2008 through 2010, during these tough economic times, we have actually generated a net profit for the U.S. Treasury of over $2 billion, and we expect to earn nearly a billion dollars more this fiscal year. And we also hold right now $14 billion in retained earnings on our balance sheet.

Such strong financial performance is evidence that Ginnie Mae is an excellent example of smart and efficient government. For more than 40 years, the corporation has served as a principal financing arm for the government mortgage products, ensuring that money flows into the domestic housing market.

In 1970, our corporation pioneered the MBS, mortgage-backed securities. We created the first mortgage-backed security and spearheaded the development of the TBA market. As you know, the TBA market, forward trading of MBS, allows borrowers to lock in interest rates on their mortgage before they actually close their loan. These markets create substantial liquidity that gives lenders consistent access to capital. Effectively recycling capital allows lenders to finance 30-year fixed-rate mortgages at reasonable rates for their borrowers.

Through our organization, the U.S. Government attracts private capital into the U.S. housing market and finances government-insured products without raising the national debt, while minimizing taxpayer exposure. In fact, Ginnie Mae, in contrast to many other MBS entities, earned a profit each year during the housing downturn. In Fiscal Year 2011, it is expected to be our best year ever, as mentioned before, making approximately a billion dollars.

This performance can be attributed to our business model. The corporation does not buy or sell securities or loans for investments. Our conservative approach to management rests on our solid, inherently risk-adverse business model, the foundation of which is a simple pass-through security backed by government-insured loans issued by private lenders. Our program is designed so that the capital of the lenders who issue Ginnie Mae securities is available to assume losses before Ginnie Mae or the taxpayers are exposed to loss. Having lenders act as issuers of the securities has the added benefit of ensuring the lenders actually have skin in the game. This provides an incentive for lenders to originate well-performing

loans. The extra layer of capital is critical to mitigating taxpayer risk.

As the market fluctuates, and lenders face increased risk, we have made several changes to strengthen our risk-management practices. These include increasing net worth requirements, and establishing capital and liquid asset requirements for all issues across all of our business lines. The liquid asset requirements are especially important to ensure our counterparties have the ability to meet their payment obligations.

As we continue our programmatic adjustments, and as Congress deliberates ways to reform housing finance to better suit the current conditions, it is critical we get this right. The proposed QRM regulation recognizes that risk retention is an important part of creating a sustainable housing finance system. Issuers and originators must have an incentive to make sustainable loans. Without it, we risk another crisis. Our challenge is to craft a balanced approach that protects borrowers and allows a robust flow of capital.

I appreciate this opportunity to share comments on the initial discussion draft which are contained in my written testimony. I wanted to note that the legislation includes a provision that gives the CFO of Ginnie Mae the ability to offer independent views on matters concerning Ginnie Mae. While we understand the committee's desire to maintain a close review of our financial condition, we respectfully believe this provision is not necessary. We are a relatively small agency. My staff and I are directly responsible to inquiries from Congress and from this committee, and HUD Office of the Inspector General provides independent oversight.

To the extent the committee believes additional oversight may be necessary, I would recommend that the focus be placed on the role of the agency's chief risk officer, because the major risks to Ginnie Mae center on the capacity of its issuers to meet their obligations to investors and the deterioration of their value-to-servicing portfolio. Thus, potential problems at Ginnie Mae are likely to be identified through our risk-management practices and issue-monitoring activities long before it impacts our financial condition.

Chairwoman Biggert and Ranking Member Gutierrez, our housing finance market remains fragile. Congressional action, Administration effort, and government programs would help to address the economic and housing upheaval, provide needed liquidity, and help keep the market from complete collapse.

While Ginnie Mae has been a stabilizing force in the housing market, the Administration believes a meaningful reform is needed so private investors can return, and I hope my testimony today has contributed to greater understanding of Ginnie Mae and the value it contributes to our housing finance system. I am committed to strengthening this unique organization so that it continues to make a sound contribution, and I welcome the opportunity to work with Congress on this effort. I look forward to answering any questions you might have. Thank you.

[The prepared statement of Mr. Tozer can be found on page 59 of the appendix.]

Chairwoman BIGGERT. Thank you.

We will now turn to questions from members, and I will yield myself 5 minutes.

Mrs. Galante, the Administration estimates from last year, you said that if the required payment rose to 5 percent, then 300,000-plus homebuyers would be locked out. Do you know how that figure was determined?

Ms. GALANTE. Yes. This was based on homebuyers that we financed last year, and, if they had to provide a higher downpayment, how many of them would not have qualified.

Chairwoman BIGGERT. Was this a study that was done of all homebuyers or—

Ms. GALANTE. No. Thank you for letting me clarify this. This was just of borrowers who were FHA borrowers. We looked at the particular characteristics of those buyers this past year and did a quick analysis of how many of them would not have qualified if they would have had to pay a 5 percent downpayment.

Chairwoman BIGGERT. Okay. Could you submit that data or the study so that we could have GAO look at that for further review?

Ms. GALANTE. Sure, we can provide that information to you.

Chairwoman BIGGERT. Thank you.

This was kind of what I was asking the Senator about the QRM. First of all, how would the higher downpayment requirements in the QRM impact FHA?

Ms. GALANTE. Yes. Thank you for the question.

This is obviously a challenging topic at this point in time, and I want to say that where we are, just to be clear where we are in the process, is that absolutely no decisions have been made about what the downpayment requirements will be. There was a published rule for comment, and the comments were due August 1st, and many, many comments were received.

Chairwoman BIGGERT. But let us say it was decided that the downpayment should be 20 percent. How would that affect FHA?

Ms. GALANTE. Again, it is difficult to predict how this rule, if it were put into effect, would affect FHA. I do want to say, again, it was a rule around risk retention for financial institutions making loans that will be sold to investors and ensuring that those lenders had some skin in the game with respect to risk retention. And so it is a very different apples and oranges with FHA.

Chairwoman BIGGERT. Okay. Do you have any estimate, any guess how it would affect; would there be more borrowers, or would there be less or would it be the same?

Ms. GALANTE. Again, I really do not have any particular estimate on that that I could provide you.

Chairwoman BIGGERT. Okay. Then, Ms. Trevino, some of the concerns raised in the FHA and RHS discussion draft deal with the preservation of institutional knowledge currently in place at the RHS. Should that be moved to HUD? I know you don't want that to go through, but let us assume that it did, or are you using that in your working group where you said that these agencies are working together?

Ms. TREVINO. Chairwoman Biggert, thank you for that question.

I believe that we currently work together very well. I believe it would be very premature to propose this type of move. Currently, Rural Housing Service addresses the needs of rural America very efficiently. We believe that those are the concerns of the country

right now, and that is the efficiency of our programs and the cost-effectiveness of our programs.

Chairwoman BIGGERT. You have the working group. Was that just formed recently?

Ms. TREVINO. Yes, ma'am.

Chairwoman BIGGERT. And why was that formed?

Ms. TREVINO. The one on single family or the rental policy? The whole idea is to work in synergy with the other housing programs across the Federal Government. We do not believe at Rural Housing Service that horizontal integration of housing programs across the Federal Government are always the answer. We believe that when the consumers are as complex as our rural consumers, that horizontal integration is just one way to look at it, and there are better ways to look at how we provide services.

I would like to give you an example: in the private sector, I think you have all heard of the company Apple and iTunes. They are one of the best companies in the world at being able to predict environmental dynamics and being able to determine what their customers require, and we believe that at Rural Development, we do that. Apple could have done what all their competitors do, and they could have gone out there and created a great computer. They could have had a great operating system. They could have done a software that allowed them to—

Chairwoman BIGGERT. Okay. And I agree that is a great company that has done a lot. So what do you see or predict for housing services?

Ms. TREVINO. We believe that you would upset the synergy that currently exists. We don't believe that in an area like rural America that is as complex as it is, that having this type of integration is the answer.

Chairwoman BIGGERT. Okay. Thank you. My time has expired. The gentleman from Illinois.

Mr. GUTIERREZ. Thank you.

Mrs. Galante, you mentioned that a 5 percent downpayment requirement on FHA loans would have prevented 345,000 families from buying homes had it been in place this past year. You are 3½ now, proposed 5 percent. Can you give us more detail on the impact this proposal might have on the broader housing market? Are there any indications, any, that the private market is ready to pick up the slack?

Ms. GALANTE. Yes. Thank you for the question.

Again, this is a traditional—I want to say traditional role for the FHA, to provide financing opportunities for low- and moderate-income buyers, and we have been providing this type of financing with 3 percent or 3½ percent downpayments, I think, since 1953. So this is a core constituency of the FHA, core customer of the FHA, and they would clearly be impacted if we went to a flat across-the-board 5 percent minimum downpayment.

And I do want to also stress that what we are asking for is just that it not be an absolute minimum standard requirement. We do have flexibility today, and we use that flexibility to look at the combination—as I said in my testimony—of FICO score and downpayment, and that is a much better predictor, and as a result of that, we have required higher downpayments for those with very low

FICO scores. So it is not that we can't provide that flexibility and think that we should.

Mr. GUTIERREZ. How has business been recently over at the FHA?

Ms. GALANTE. To some other questions that were asked of the earlier panelists, I would say this: We obviously rose to a peak in the market where we were 30 percent or more of mortgage financing.

Mr. GUTIERREZ. What were you in the last 12 months?

Ms. GALANTE. I was just going to say, but over the last 12 months, we actually have come back down to, I think, around 17 percent of the market. So we are still fairly robust, but we have started to scale back under the current scenarios and under the current rules and conditions.

Mr. GUTIERREZ. How much has the FHA cost the Federal Government during—the American taxpayer during the last 10 years?

Ms. GALANTE. Again, the FHA is self-sustaining, and is—we charge—

Mr. GUTIERREZ. I wanted to see if there was a difference, because every time I come to one of these meetings, I put a bet, and I always win it, that Fannie Mae and Freddie Mac are going to get mentioned at least half a dozen times. So I am well on the way, and by saying that, I might have messed up my bet, but I won't, because they can't help themselves. Fannie Mae and Freddie Mac will be mentioned again and again.

So unlike Freddie and Fannie, you don't lose any money?

Ms. GALANTE. That is correct. We have a robust—

Mr. GUTIERREZ. And recently you have had up to 30 percent of all the mortgages that are being issued in America?

Ms. GALANTE. That is correct. Again, we—

Mr. GUTIERREZ. And if we raised it to 5 percent, 345,000 families would not have gotten a loan from your agency?

Ms. GALANTE. Again, if you use those—that as a predictor from last year's borrowers, you use that as a predictor, yes.

Mr. GUTIERREZ. And I know that Senator Isakson said that it was critically important to the economy that we get construction started once again. First we have to obviously be able to sell homes. People have to be able to get mortgages.

Let me ask you one other question. How about rentals? How are we doing on—because there are a lot of people who can't own a home, but they—how are we doing with developing so that people will create rental units for people to—

Ms. GALANTE. Yes. Actually, the FHA multifamily and health care programs have grown significantly in this past few years, partly because there hasn't been capital in the private market available for those facilities as well, and so we have been producing over 100,000 units a year with the financing that FHA has been able to provide.

Mr. GUTIERREZ. Last question. I have 19 seconds, and I promised I wouldn't go over. So you are about 17 percent today?

Ms. GALANTE. That is correct.

Mr. GUTIERREZ. What were you 5 years ago?

Ms. GALANTE. I don't know that exactly.

Mr. GUTIERREZ. What historically have you been?

Ms. GALANTE. Historically, before this crisis, it was 2 or 3 percent, I think.

Mr. GUTIERREZ. So you went from 2 or 3 percent to up to over 30, and you are back down to 17 percent?

Ms. GALANTE. That is correct.

Mr. GUTIERREZ. All right. We need to keep you working. Thank you.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from Virginia is recognized.

Mr. HURT. Thank you, Madam Chairwoman.

And building on, following up on his question actually, do you believe that your market share—and maybe could you just talk about this in the context of a couple of things. Do you believe the market share that you all currently occupy is larger than what FHA was designed to handle? And can you talk about that market share in the context of, certainly, I think, of an opinion of a majority on this committee who believes that we want to see more private capital in the system, not less, and is the market share that you occupy crowding out private capital? Can you just talk on that subject generally?

Ms. GALANTE. Yes, thank you. That is a very important question, and I would say this: We have been on record before, and I will go on record again, that we certainly do not believe that the FHA should be 30, 40 percent of the market. That we do want the private capital to come back into the market is one of the reasons that in the White Paper on the future of housing finance we supported the expiration of the higher mortgage loan limits for the Economic Recovery Act. And so we are—we think that is a first step in stepping back FHA's role in the market, and we think that is an important thing to do.

What the right percentage is of a sustainable FHA for the future, what is the exact percentage it should be? It certainly ought to be at less than 30 percent. We use in our modeling—I think we could be sustainable if it were 10, 15 percent of the market, but we are not looking to stay up higher than those numbers.

Mr. HURT. But did you say that before 2008 it was less than 5 percent?

Ms. GALANTE. Yes, I believe that is correct.

Mr. HURT. Do you believe that is—can you explain why that is too little?

Ms. GALANTE. I am not saying that it is too little. I am just saying we can expand and contract as we are needed. We are there to provide a countercyclical approach in the marketplace, so it is not that it is not okay if it is down at 2 or 3 percent. It is that we can handle probably on a sustainable basis something higher than that when it is necessary.

Mr. HURT. Okay. And in this second question I would like to hear from each of you because of your expertise in this area. It has been observed, it has been opined that we are not really going to see a true housing recovery in this country until we hit the bottom. I would love to hear each of you speak to the question as to whether or not we have hit that bottom and why or why not.

Ms. GALANTE. Sure. Thank you again for the question.

This is one of those moments where I guess I wish I were an economist, and I am not. I don't know whether we have hit the bottom. I think we see some very mixed signals. We have seen some house pricing increases in the past 3 months. We think that is a positive sign. So I think we are still in a fragile place, but we do think things are slowly improving.

Mr. HURT. Thank you.

Ms. TREVINO. I have to say that in rural America things seem to lag, and you are going to see things happen in rural America anywhere from 6 months to 2 years later. So, we may not have seen the worst of what the economy is going to do, and yet again we are seeing some good numbers coming up. And so we are very encouraged that we are going—that it is kind of an up-and-down cycle.

We believe that in rural America it is a little different than in urban America. Folks who lose their homes there are going to be because of family circumstances, such as divorce or a complete loss of jobs. And so we are not seeing as much of the housing market effect in rural America that we saw in urban America, but, again, they do tend to lag, so I couldn't tell you.

Mr. HURT. Thank you.

Mr. TOZER. Basically from my perspective, we may be closer to the bottom than we may think. The reason I think so is that I have heard from numerous money managers. Being in the position at Ginnie Mae, I talk to a lot of the major money managers around the country, and they really are looking now at potentially buying blocks of real estate. I always look because my background is in capital markets. Whenever you start seeing smart money coming in, it looks like you are maybe getting close to the bottom. Again, I am saying "close" because I don't think we have hit bottom, but we are probably getting close, knowing that a lot of the money managers are looking very seriously at buying real estate, and you see it in the REALTOR® numbers. I think last month approximately 30 percent of all the transactions were cash, which indicates to me it is probably being bought by people who are buying the property as an investment. So that leads me to believe that maybe there is some glimmer of hope that we may be getting closer to the bottom than maybe we think, but who knows? Wall Street has been wrong before.

Mr. HURT. Yes, thanks.

Chairwoman BIGGERT. Thank you.

I would ask particularly Ms. Trevino and Mr. Tozer, if you are seeing evidence of that or have the numbers for how close or what is happening in the market, I would really like you to submit that. Thank you.

Mr. Cleaver, you are recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Let me begin maybe with Mr. Tozer. Would you say that the fact that FHA loans increased from 2 to 3 percent up to 30 percent represents some kind of either increase in fraud or loosey-goosey requirements or underwriting standards?

Mr. TOZER. No. My feeling is, again, when FHA hit the 30 percent market share was a point that private capital had been really shook up from the perspective of the problems and a lot of other

aspects, private labor markets and so forth, to the point where people were reluctant to invest in loans that were not guaranteed by the U.S. Government, and so because of that, Ginnie Mae picked up a large market share. But I don't think people were drawn to the FHA program because of the underwriting standards. It is more the fact of lack of private capital because of the amount of losses taken in the private-label market.

Mr. CLEAVER. If we raised the downpayment requirements to 3½ to 5 percent, do we have any empirical evidence that the private sector will pick it up?

Mr. TOZER. In today's market right now, it is probably somewhat limited as far as the availability because of the healing factor that is going on right now in the private sector, but I really can't speak to the magnitude. There is interest. The private sector always finds a price for things, but the question is, I think it is probably limited as far as the availability today just because of the healing process that the private sector is going through right now.

Mr. CLEAVER. I am going to shamelessly say that my cousin, who actually lives in Congresswoman Waters' district, is president-elect of the California REALTORS® Association. I was out there a week ago and had a chance to talk to him about real estate and how houses are being sold in California. His concern was that if we raise the downpayment requirement, that it is going to hurt the industry, and the industry is already in a depression. Do any of you see that differently?

Mr. TOZER. Again, I really can't speak to it, because, again, my responsibility is kind of the capital markets side, but to understand how it plays out and what you are seeing at the primary market, I really don't have the expertise to talk about it from that perspective, to understand what the impact would be.

Ms. GALANTE. So, again, I would just say that for some borrowers the ability to have the 3½ percent downpayment and not being locked in to having to put down 5 percent is a huge difference in terms of their ability to qualify. And FHA needs to look closely at the underwriting of every borrower, and if, again, their credit score is too low, then you may want to require a higher downpayment. But that combination is, again, just a much better predictor of a person's success, and so we really feel strongly that we don't want to be just locked in to it must be 5 percent and above, and, again, historically FHA has been serving that underserved borrower, and we want to be able to continue to do that when circumstances allow for it.

Mr. CLEAVER. But we could exclude, by raising the downpayment, individuals who could, in fact, afford with standard underwriting procedures homes, but could not come up with a downpayment, particularly in a recession?

Ms. GALANTE. That is correct, yes.

Mr. CLEAVER. Ms. Trevino, do you agree with that?

Ms. TREVINO. Yes, Congressman, thank you, and I do agree with what has been said. In rural America, we are not going to see the type of private-sector involvement in terms of making rural loans, and therefore the ability for us to continue a no-down-payment program that we have is essential. Rural Americans make on the average $10,000 less than their urban counterparts, and very seldom

can afford that downpayment, so we would have a huge loss of homeowners or new homeowners in the future if we required that.

Mr. CLEAVER. Thank you.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

The gentleman from New Jersey is recognized for 5 minutes.

Mr. GARRETT. I thank the Chair, and I will begin where the Chair was asking Ms. Galante, with regard to the numbers that you said, that if we raised from 3½ to 5 percent, you said it was 300 what?

Ms. GALANTE. Three hundred forty-five thousand. Again, estimate based on if those were the same borrowers that we would be approaching going forward.

Mr. GARRETT. Sure. And so when you say it is an estimate, in reality, did you actually scrub the numbers? If I was one of those categories in that list, did you scrub my asset list to see whether or not I actually had the additional funds to go to pay that extra money?

Ms. GALANTE. So, again, thank you.

I do want to be clear. This is not a long-term, longitudinal, robust study. This was an estimate based on a scan of—

Mr. GARRETT. But it is not—let us be clear, it is a statistical analysis of how many people had the 3.5 who applied for that, and how many would be at the 5 percent; not really going back and saying, of the ones you looked at, do you, Scott Garrett, have—if I was going to buy a half-a-million-dollar house, 3½ to 5 percent, I would need another $7,500 roughly, right, to go to that? You didn't go in and say, Mr. Garrett, do you have all the additional $7,500, or can you secure that someplace else, so you could come up with that number, or did you do that?

Ms. GALANTE. We did not. And, again, I would be happy to provide you the level of work that went into that estimate.

Mr. GARRETT. So in reality you don't know, and because—and just using that scenario, hypothetically, for somebody to go from 3½ to 5 percent, $7,500, having just gone through this with my own house, that is the cost of a new furnace, for example. For that individual you really want to make sure that individual has not only the wherewithal to pay the mortgage each month on that half-a-million-dollar house that he is buying, but also the upkeep of the house. He should be able to afford all the other things. So he should be able to afford that extra $7,500 if next week, tonight, you find out that your furnace goes, your hot water heater goes and that sort of thing.

So that is all part of the equation. So we really don't have the data to say how many people lost out, would lose out, if we go from 3½ to 5 percent.

Ms. GALANTE. Again, it is a rough estimate. We did look at the reported assets that were in the loan file at the time the loans were made. We do do full underwriting, so we do have full information on these borrowers.

Mr. GARRETT. One of your statements was, "we were trying to serve the underserved borrower." One of my questions is, who is that? Is the underserved borrower the person who is trying to buy a million-dollar house really? Because if you are borrowing

$750,000, you may be buying then a million-dollar house. Is that really what the intention or the purpose of the FHA is to provide that person? Because as I said in my opening statement, that person is making a quarter of a million dollars. Do you really see that as your role?

Ms. GALANTE. This is an important issue, and we have been clear, again, in the White Paper that we support lowering the limits back to the traditional FHA formula for setting loan limits.

Mr. GARRETT. So what would that be?

Ms. GALANTE. It varies by regional jurisdiction, and I just will say this: The reform bill before us would take that methodology that we use right now, which is based on a median income for a county in a standard, in an MSA, so in a region, and drill it down even further to just county by county.

Mr. GARRETT. You heard the opposition to that.

Ms. GALANTE. Right, and we do have some concern with the impact of that. But just going back to where it has traditionally been, 125 percent of the median for the area, will be a step back for FHA in the marketplace.

Mr. GARRETT. Let me ask you a question we dealt with over in the Budget Committee. CBO, the Congressional Budget Office scores Fannie and Freddie—yes, I will bring them up today—by including market risk when they evaluate them, when they score them. Do you believe that we should be scoring market risk also with FHA? And, if so, how do we accomplish that? Is that something you can do by yourself, or is that something that you should encourage Congress or the Administration to do?

Ms. GALANTE. This is a very interesting question. I actually did look at the CBO study, and I would say this: The concept of fair value accounting is really based if you are looking at liquidating a company and how you account for that company. So FHA is controlled, as you know, by the Federal Credit Reform Act and accounting standards for that. We do look at and are continuing to improve our models for looking at underlying economic risks, so what is happening, what are the trend lines in the marketplace, what is happening with house prices. So when we do our actuarial studies of what kind of losses we might take, we are every year getting more and more sophisticated about how we do that statistical—

Mr. GARRETT. So you will get market risk in there?

Ms. GALANTE. So we will get economic factor risks. And when you say market risks, the Federal accounting rules, we don't apply, for example, what it would cost if we were borrowing private capital because we are not, in fact, borrowing private capital. So it really doesn't make sense, in our view, to take it to that extent. We do agree that it is important from an actuarial basis to be understanding market and economic risks that are happening in the marketplace.

Mr. GARRETT. I yield back. I see my time is over. Thank you.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Picking up on the questioning of the gentleman from New Jersey, he has experience in many things, but not buying

a home in the Los Angeles area, and I think that there is only—I am aware of one bipartisan piece of legislation that Congress could take in the next month or two that would help avoid a double-dip recession, and that is legislation to maintain the qualifying loan limit. If we don't keep the $729,750 in the Los Angeles area, there will be a precipitous decline in the value of all properties as those properties where you need a 729 loan all of a sudden drop by $100,000, and the homes a few miles away that are more modestly priced will, in turn, drop by $100,000. And whether that means a double-dip recession only in 10 major areas in this country, or whether it means a double-dip recession for the entire country is an economic experiment that I don't want to carry out on the American people.

If we see a decline in effective demand for housing, that is to say not just new families who want a home, but families who can qualify, we are going to see a precipitous decline in the price of housing, the value of housing again.

Ms. Galante, all my questions are for you. You are the winner.

Ms. GALANTE. Thank you.

Mr. SHERMAN. There was a time when the private sector could provide loans in excess of the conforming loan limit without the involvement of Fannie, Freddie, Ginnie Mae, and FHA. Our financial system is broken right now. It remains broken. Is there any current evidence that the marketplace is prepared to service loans above the conforming loan limit? And I don't mean—Malibu homes will do just fine. If you need $20 million to buy a home in Malibu, you probably own a bank, but the loans in that 417- to 625-, 625- to 729-, is there any evidence that the private market is right now able to step in with reasonable rates and reasonable terms?

Ms. GALANTE. I appreciate the question. And let me just say, we obviously are in a difficult time, and making these judgments about where the market is going, where the housing market is going, and whether private-sector capital will come back in at specific places is difficult to make. Again, our judgment has been that for the FHA, at this point in time, the step back from the higher limits to what they traditionally have been is something that can be done without major impact.

Mr. SHERMAN. Are you speaking also as to qualifying loan limits for Fannie and Freddie, or is your focus just on the FHA?

Ms. GALANTE. My focus is just on the FHA.

Mr. SHERMAN. Okay. I would like to move on. Ignoring the 10 high-cost areas in the country, is the Administration concerned that lowering the formula from 125 to 115 is going to make home ownership unavailable and hurt the housing market?

Ms. GALANTE. Are you talking about the formula in the FHA reform bill?

Mr. SHERMAN. Yes.

Ms. GALANTE. We are concerned that the elimination of the national floor and going to a county-by-county assessment in particular could have a major impact on how low the formula would drive the maximum FHA loan limits down considerably in a number of places.

Mr. SHERMAN. The whole purpose of the 5 percent retention was to make sure that the private sector had skin in the game. These

are private-sector experts, not just people buying a mortgage pool. And now that private-sector expertise with skin in the game could be the originator, probably could also be the private mortgage insurer.

The proposed QRM rule would exempt FHA-insured loans from the risk retention requirements, but it would not exempt loans insured by private mortgage insurance. Private mortgage insurance is private capital and is an alternative to the FHA. Unlike the FHA, private mortgage insurers place private capital in the first loss position rather than the taxpayer. Shouldn't the Federal housing policy ensure that private mortgage insurance, which relieves the taxpayer of risk, is not disfavored compared to government alternatives in the QRM rules?

Ms. GALANTE. Let me just say that the QRM is still under advisement with an interagency—

Mr. SHERMAN. That is why I asked the question, to make sure that those writing those rules get your input on this important question.

Ms. GALANTE. Yes. Thank you, and we will—I know we are taking all of those comments under advisement.

Mr. SHERMAN. They want to hear from you. Do you have an answer to my question?

Ms. GALANTE. Because we are in that rulemaking progress, process number 1 and number 2, I should just be clear that I am not the main point person for HUD on the QRM. Mr. Ryan is leading that effort. And, again, we are one voice of a number of voices as part of that rulemaking process.

Mr. SHERMAN. Thank you. I will also have some questions for the record. Thank you very much.

Chairwoman BIGGERT. Perhaps Mr. Ryan could respond for the record?

Ms. GALANTE. Thank you.

Chairwoman BIGGERT. The gentlelady from California is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman. We have returned to work, and you got right on it with one of the most important issues of our time, what is going to happen in this housing market, and in particular what is going to happen with FHA, and, of course, what is going to happen in the whole discussion about loan modifications, and how are we going to make sure that FHA is financed in ways that it can carry out its mandate, etc.

I suppose I could ask a thousand questions, but I am really interested in hearing from any of you who would like to volunteer, what do you know about the rumors about the Administration's ideas about what to do with the housing market relative to homeowners who are underwater, who can't get loan modifications, who find themselves languishing in kind of a no-person's-land here with the banks appearing to—and the servicers, rather, not moving very aggressively on loan modifications. At the same time, no principal write-downs taking place, no real refinance program. Can you help me? What do you know about any of this? It is unfortunately bogging this country down with a crisis that seems to have no end. What can you share with us, Mrs. Galante? What do you know about any of this?

Ms. GALANTE. Yes. Let me just say this: You are absolutely correct. There are a number of programs for loan modification and other opportunities for homeowners who are in crisis. FHA, for example, just recently extended our forbearance agreements for people who are unemployed from 4 months to 12 months to help those in that difficult situation.

So there are a number of things that we are doing, and there are people being helped, but we are also concerned that we want to be looking at every opportunity to do more. We have a short refi program which is specifically for underwater homeowners. It has, again, not been utilized as much as we would like. So we will continue to look for opportunities to improve the loss-mitigation efforts and to help homeowners retain their homes, and we are actively working on those concepts.

Ms. WATERS. Where do you stand with the discussion by attorneys general, the Attorney General of New York in particular, who would like to sue these institutions that have evidently been involved in less than honorable tactics, and where does that put FHA? Do you have FHA-financed insurance properties that you consider have been a victim of these practices?

Ms. GALANTE. Thank you for a very important question. FHA and HUD, as you may know, have been actively involved in conversations with the major servicers on ensuring that they follow—FHA actually has standard loss-mitigation procedures that are required of servicers, and when they are not following them, we have actions that we can take against those lenders. And we are in active conversations, as you might know, with the attorneys general across the United States on some of these issues, and some of that work comes from some initial work that FHA did in bringing forth some of the situations that we found in our reviews of these lenders. So I am not in a position to talk any more about those conversations at this point, but we hope to be able to do that soon.

Ms. WATERS. Thank you very much, Madam Chairwoman. I yield back.

Chairwoman BIGGERT. Thank you.

The gentlelady yields back.

The gentleman from Texas. Thank you for being with us, Mr. Hinojosa. You are recognized for 5 minutes.

Mr. HINOJOSA. Chairwoman Biggert, I want to thank you for holding this hearing today and for permitting me to participate in the hearing. I commend all that you and Ranking Member Gutierrez are doing to help improve the housing situation in our United States.

On July the 18th, I introduced H.R. 2573, the Rural Health Care Capital Access Act of 2011. The bill would provide critical-access hospitals the opportunity to apply for cost-efficient financing to expand, update, and renovate their aging facilities.

Senator Herb Kohl of Wisconsin introduced a companion measure in the Senate, S. 1431. The amendment allowing critical-access hospitals to qualify for the Section 242 insurance program expired July 31st. Both pieces of legislation would permit these critically important hospitals to qualify for the Department of Housing and Urban Development Section 242 Mortgage Insurance Program, so if Congress were to fail to pass either bill and again extend the De-

partment of Housing and Urban Development Section 242 Mortgage Insurance Program, no additional critical-access hospitals would be eligible for HUD's mortgage insurance program.

Secretary Galante, would you explain on page 11 of your written testimony, for everyone's benefit, what critical-access hospitals are, and tell us their purpose, tell us how they benefit communities, and lastly the number of them that have benefited from HUD's Section 242 Hospitals Mortgage Insurance Program.

Ms. GALANTE. Yes. Thank you very much for the question.

So critical-access hospitals are hospitals in rural communities that are permitted under HHS rules for Medicare reimbursements to operate facilities that have services and get paid for those services that traditional hospitals would be capped at the amount that they could receive. And the reason for that, as an example, they could provide extended care to an elderly—frail, elderly person where normally the Medicare would require that person to be moved. Since there isn't an easy place to move that person, these critical-access hospitals can get higher reimbursements on an ongoing basis, and that is the piece of—the exemption to allow that to happen is what expired on July 31st. So it is important that those hospitals be able to have that income to qualify for financing under our 242 FHA program.

So these, again, are providing very critical services in very rural communities, and the FHA is financing the rehabilitation or perhaps a new wing, that type of thing, of those hospitals. And I do want to be clear. Again, like other FHA programs, these financings do not cost the taxpayer money. They are self-financing, essentially, with the fees that are charged for these hospitals, but it enables them to do these important renovations, provides jobs in the community, significant community benefits from that perspective as well. And I believe we have insured about 26 of those hospitals over the past number of years, and there are a number in the wings that would appreciate this ongoing opportunity.

Mr. HINOJOSA. Thank you for answering my questions. I represent deep south Texas all the way to central Texas, and much of my district is rural; 125 communities and three-fourths of the geographic area is rural. So this is something very important. And as you well know, Texas is suffering right now, having lost about 1,400 homes in the last 3 days to fires in central Texas up around Bastrop County and the surrounding area. And so the questions I am asking are very important to rural America, and we need the Administration to help us so that these two bills that I mentioned both in the House and the Senate can pass and be available for those counties that need your help.

Madam Chairwoman, I wish to acknowledge Ms. Tammye Trevino for all she has done and continues to do to improve housing conditions, to provide funding for USDA rural housing programs. My area has benefited a great deal, and we want to thank you for what you have done.

Ms. TREVINO. Thank you, Congressman. I appreciate the comment.

Mr. HINOJOSA. Madam Chairwoman, with that, I yield back.

Chairwoman BIGGERT. The gentleman yields back, and without objection, I ask unanimous consent that the following statements

be submitted for the record: a statement from the Mortgage Bankers Association dated September 8th, 2011; a statement from the National Low Income Housing Coalition dated September 8th, 2011; and a statement from the Community Associations Institute dated September 8th, 2011.

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

And with that, I would like to thank the witnesses for being here. I really appreciate it, and I think it will be very helpful as we go forward considering FHA and the draft legislation. And with that, I thank you again, and this hearing is adjourned.

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

A P P E N D I X

September 8, 2011

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

Written Testimony of Carol J. Galante
Acting Assistant Secretary for Housing – Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development

"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets"

Hearing before the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity
Thursday, September 8, 2011

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the current priorities of the Federal Housing Administration and the discussion draft legislative proposal to strengthen FHA, RHS, and Ginnie Mae. FHA is critically important to ensuring the continued availability of mortgage credit for single-family homes, multifamily properties, and healthcare facilities during this economic recovery. We share Congress' goal of ensuring that FHA will continue to fulfill its mission and enable responsible lending in a fiscally sound manner that protects taxpayers and facilitates the return of private capital.

FHA LEADERSHIP AND PRIORITIES

I am honored to have been asked to serve as Acting Assistant Secretary for Housing and Federal Housing Commissioner. I have served as HUD's Deputy Assistant Secretary for Multifamily Programs since May 2009. During the past two years, I have overseen significant growth in FHA's Multifamily portfolio while implementing strong risk management practices and leading the Administration's housing policy development in Multifamily Finance for both market rate and assisted properties. Prior to joining the Obama Administration, I was President and CEO of BRIDGE Housing, one of the largest developers of affordable and mixed income/mixed use housing in California, and I have more than three decades of experience in real estate and housing finance and results-driven organizational leadership.

It has been and will continue to be a pleasure to work with the many dedicated employees and leaders at HUD, including Bob Ryan, FHA's first Deputy Assistant Secretary for Risk Management and Regulatory Affairs.

As you know, Bob previously served as Acting Commissioner and is now Senior Advisor to the Secretary for Housing Finance, where he is leading policy development on housing finance issues, including the future of the GSEs and the government's role in the mortgage industry. I will be working closely with him, given the vital role FHA plays within the broader housing finance system.

As Acting FHA Commissioner, I will build upon Secretary Donovan's vision and leadership and focus on the following three priorities:

- Stabilizing the Housing Market and Assisting Homeowners to Avoid Foreclosure
- Ensuring the Continued Fiscal Health of FHA and Strengthening its Risk Management
- Ensuring Responsible Access to Credit and Liquidity, particularly for under-served communities.

Stabilizing the Housing Market and Assisting Homeowners to Avoid Foreclosure

While much progress has been made in stabilizing the single-family housing market, HUD and FHA are committed to continuing to improve upon efforts to assist responsible homeowners to avoid foreclosure. Through the combined efforts of FHA's Loss Mitigation, Making Home Affordable, Hardest Hit Fund, Emergency Homeowners Loan programs, and the HOPE Now alliance, more than 5 million homeowners have been helped to avoid foreclosure since April 2009, as reflected in the most recent Obama Administration Housing Scorecard.

[http://portal.hud.gov/hudportal/HUD?src=/initiatives/Housing_Scorecard].

The Administration is dedicated to helping homeowners who were negatively affected by the housing crisis and this month's scorecard shows signs of these programs working. Data shows improvements in home prices, which have increased three months in a row, and a reduction in foreclosure starts and completions, which have been trending downward since fall 2010. Although the data suggests improvement, we are still continuing to work with homeowners, lenders, servicers, and others so that this positive trend continues.

Recently Announced Unemployment Forbearance Programs. On July 7, 2011, the Obama Administration announced adjustments to FHA requirements that will require servicers to extend the forbearance period for FHA borrowers who qualify for the program from four months to 12 months and will make it easier for unemployed borrowers to qualify. In addition, effective October 1st 2011, the Administration will require servicers participating in the Making Home Affordable Program (MHA) to extend the minimum forbearance period to 12 months wherever possible under regulator and investor guidelines. These adjustments will provide much needed assistance for unemployed homeowners trying to stay in their homes while seeking re-employment. These changes are intended to set a standard for the mortgage industry in providing more robust assistance to unemployed homeowners in the economic downturn.

Established FHA Loss Mitigation Efforts. Homeowners with FHA-insured loans are eligible for a range of assistance tools to help protect them from foreclosure, and lenders are required to offer these loss mitigation tools to FHA borrowers.

Since the start of this Administration, nearly 450,000 borrowers have been able to retain their homes through FHA loss mitigation programs. Assistance is available through a variety of methods, including:

- Forbearance – delayed collection actions to give homeowners time to work on solutions;
- Partial claim – FHA pays the arrears and takes a second-lien position against the home, with no payments due until property sale;
- Loan modification – payments are reduced through modifications to the terms of the mortgage;
- Pre-foreclosure sale – FHA pays the loss on a homeowner sale of the property;
- Voluntary deed conveyance – taking the deed in-lieu-of a foreclosure action.

Using FHA's foreclosure avoidance tools, In FY2010, FHA-approved loan servicers assisted over 552,000 homeowners and completed final delinquency cures resulting in home retention for almost 183,000 homeowners. Over the first three quarters of FY2011, FHA-approved loan servicers assisted more than 493,000 homeowners, and completed final delinquency cures resulting in home retention for over 164,000 homeowners. Servicers of FHA insured loans must evaluate each defaulted homeowner and consider all loss mitigation techniques to determine which, if any, are appropriate. Foreclosure cannot be initiated until all loss mitigation options have been considered.

Improving Servicer Outreach and Performance in Preventing Foreclosures. FHA is working closely with lenders and servicers to improve their outreach and performance in assisting borrowers to avoid foreclosure. In February 2010, FHA's Office of Single Family Asset Management and the FHA National Servicing Center began conducting lender visits to identify best practices that could be shared with the broader servicing community to improve foreclosure mitigation across the industry. The visits were conducted with five overall objectives: (1) better understand in specific detail the process variations that exist at each lender for providing a delinquent FHA borrower with options to avoid foreclosure; (2) discuss specific borrower trends the lenders are experiencing; (3) identify borrower circumstances that prevent them from being qualified for various foreclosure prevention options; (4) receive suggestions from the lender that might improve the process for FHA loss mitigation; and, (5) understand the differences in default/foreclosure statistics as compared to national averages. Several significant findings have been identified and FHA has been sharing them with servicers, while continuing to meet with additional lenders & servicers to continue identifying best practices that will enable underperforming servicers to improve their success in preventing foreclosures.

For example, a large FHA Servicer set up a network of relationship managers in their branch offices nationwide to assist borrowers with loss mitigation and delinquency assistance, ensuring that borrowers encountering difficulties are able to meet face to face with a representative of the servicer. Another FHA-approved servicer studied ways to make contact with delinquent borrowers early in the delinquency and began reaching out to borrowers by non-customary means such as email, texts and other forms of electronic communication, resulting in significantly higher response rates from borrowers and enabling the servicer to better determine how they might assist them.

It is worth noting that these best practices are not limited to the FHA servicer population; HUD is collaborating with the broader servicer community to improve their foreclosure prevention activities across the entire industry, which will benefit all homeowners, not just those with an FHA-insured mortgage.

In addition to the work being done with servicers and lenders by FHA's Office of Single Family Asset Management and the FHA National Servicing Center, FHA's Office of Lender Activities and Program Compliance monitors and reports various servicing statistics for all of its servicers. The statistics include performance around early payment delinquency, loss mitigation, re-default rates and workout ratio. The information is used to measure servicer quality and help FHA improve the overall performance of those who service FHA loans. The information is made publicly available through the Obama Administration Housing Scorecard.

Even with the robust guidance and assistance offered by the Single Family offices mentioned above, there are times when enforcement actions are necessary. Cases involving widespread program abuse are referred to the Mortgagee Review Board for sanctions including reprimand, withdrawal and/or civil money penalties. Under this Administration, there has been a notable increase in the number of lenders referred to the Mortgagee Review Board for material violations of origination, underwriting and servicing requirements.

Housing Counseling. HUD's Housing Counseling Program is the only dedicated source of federal funding for the full spectrum of housing counseling services. In FY 2010, the more than 2,700 HUD-approved counselors throughout the nation provided invaluable counseling services to more than 2.1 million clients who sought education and assistance to make informed housing decisions. HUD supported housing counseling services address a broad array of housing choices, including pre-purchase and homebuyer education, foreclosure prevention, HECM counseling for seniors, rental counseling, homeless assistance, and avoidance of scams and predatory lending.

One striking example of the effectiveness of housing counseling is that in FY 2010 more than 469,000 clients who were delinquent on their mortgages successfully avoided foreclosure, preventing approximately $28 billion in losses to the economy. In stark contrast, foreclosures frequently occur without servicers and borrowers ever engaging in a discussion about potential options to prevent foreclosure or other alternatives available to borrowers such as a pre-foreclosure sale or voluntary deed conveyance, which are less damaging to a borrower's financial condition.

Through the FY2011 Continuing Resolution, H.R. 1473, housing counseling grant funds were eliminated. We are working closely with the House and Senate THUD appropriations subcommittees and greatly appreciate the efforts of Chairman Biggert, Ranking Member Gutierrez, Rep. Velazquez, and others on the Subcommittee to restore funding in the FY 2012 budget.

Simultaneously, HUD has been worked to streamline and expedite its Housing Counseling grant making process.

In addition to the Department-wide effort to obligate grant funds within 180 days of budget passage, internal Housing Counseling NOFA review processes have been streamlined and HUD is working with OMB to shorten timelines to enable faster NOFA publication. Finally, HUD has made changes to its grant application processes whereby experienced, proven applicants will be provided with a streamlined, abbreviated application. As a result of such efforts, the Department reduced its average NOFA posting time from 380 days in FY2010 to 60 days in FY2011. We are committed to ensuring that HUD's much needed Housing Counseling grant funds are made available to grantees as quickly as possible to ensure the provision of vital services to communities nationwide.

Impacts of REO properties on Neighborhood Stability. Due to the unprecedented foreclosure crisis, FHA has seen dramatic increases to its volume of real estate owned (REO) properties. In March of 2011, FHA's inventory of REOs rose to nearly 80,000. As is well known, elevated REO inventories can lead to concentrated vacancies in neighborhoods, which then can have a destabilizing effect on communities. To respond to these challenges, HUD has made dramatic changes to the way in which it manages its own REO properties and is actively coordinating with multiple agencies and organizations to address broader REO management.

New HUD REO management and marketing (M&M) strategies have increased accountability among M&M contractors, improved timeliness throughout the process, and reduced inventory in communities. Under the previous M&M II model, HUD had 23 contract areas (which covered the United States, the Caribbean, Guam and the Northern Mariana Islands). For each contract area, HUD designated one contractor to monitor lenders' compliance with FHA's conveyance standards, perform property maintenance services, and market and sell REOs. The new M&M III contract model has segregated the functions of mortgagee compliance, property maintenance, and marketing and selling REO properties into three separate contracts. The three contracts are as follows: (1) Mortgagee Compliance Manager (MCM) centralizes the oversight of all pre and post conveyance activity of HUD-approved mortgagees; (2) Field Service Managers (FSMs) are responsible for property maintenance and preservation services; and (3) Asset Managers (AMs) are responsible for the marketing and sale of REOs. This separation of functions created a system of checks and balances, thus eliminating conflicts of interest. In addition, multiple AMs and FSMs (covering one contract area) spur competition amongst the contractors and provide HUD with options in the event one contractor defaults or exhibits poor performance. The M&M III disposition model streamlines operations to capitalize on the expertise of its contractors and provides flexibility to meet changing market conditions in the REO industry.

As a result of these efficiency initiatives and despite the spike in properties being conveyed to us, FHA's inventory of REOs is down to 48,324.

Monthly sales were as low as 2,725 in December 2010, but rose to an all time high of 13,609 in June, 2011. The chart below reflects the high volume of property sales over the past four months:

Month End	Total Sales
April 2011	11,806
May 2011	12,676
June 2011	13,609
July 2011	11,392

For the first nine months of FY11, ending June 30, 2011, the ***average days to list*** and the ***average days to sell*** REOs decreased by 76 days (61 %) and 25 days (12 %), respectively, as compared to fiscal year 2010.
Through partnerships with local communities and non-profits, HUD continues to create new and operate traditional REO disposition and sales programs, including:

- **Asset Control Area Program** – which offers properties in revitalization areas to local governments and nonprofits at a 50% discount for resale to income eligible families (typically first-time homebuyers);
- **Good Neighbor Next Door Program** -which offers properties in underserved communities at a 50% discount to police officers, firefighters, teachers, and emergency medical technicians;
- **First Look** – which offers properties at discounts up to 30% for NSP grantees;
- **Dollar Home Sales Program** – which offers properties in HUD's inventory for 180 days or more to local governments for $1; and
- **Bulk Sales to PHAs for Disaster Relief** – which offers properties at a 50% discount to PHAs serving families in Presidentially-declared disaster areas (e.g., Alabama and Missouri)

In addition to the programs listed above, on August 10, 2011, FHFA, in consultation with HUD and the Department of the Treasury, issued a request for information (RFI) seeking input from a wide-range of stakeholders to explore new options for selling single-family REO properties held by Fannie Mae and Freddie Mac and FHA. To date, the Enterprises' and FHA's sales of REO proprieties have focused on sales of individual properties. With this RFI we are seeking more dynamic ways to transition this property, so that the Enterprises can move this inventory more quickly and in a way that is more beneficial to communities and home prices. Taking steps to transition some of this inventory through increased private investment into rental or other productive uses will help stabilize neighborhoods and home values at a crucial moment in our economy. Responses to the RFI are due by September 15, at which time FHFA, HUD and Treasury will begin to evaluate the ideas and options submitted.

In addition to the RFI we released, we continue to explore alternative strategies designed to help stabilize communities while also bringing value to our fund. One such strategy we are currently exploring on a pilot basis is our Mortgage Acquisition and Disposition Initiative ("601 – Note Sales Program"). The initiative gives the Department a second acquisition option: acquiring mortgages upstream as opposed to waiting until the borrower has lost their home to foreclosure and the property becomes an REO. Prior to participating in this program servicers are required to exhaust all of FHA's standard loss mitigation options. Once they have done so, rather than proceeding to foreclosure and eviction, they submit a claim and assign the defaulted mortgage to FHA with the borrower still in the home. This option aligns the interests of the servicer and FHA to review the mortgage and identify strategies for the borrowers to keep their homes.

Once they are assigned, FHA sells the mortgages to a new entity through open auctions, held quarterly. Regardless of the loan's performance, the entity who acquires the notes from FHA is prevented from foreclosing on the borrower for an additional six months. We feel that this program will be a welcomed addition to the Administration's foreclosure avoidance tool kit.

Ensuring the Continued Fiscal Health of FHA and Strengthening its Risk Management

Secretary Donovan and I recognize the critical importance of strong risk management efforts at FHA. That is why a top priority for me is to build on the work that has begun in establishing the new Office of Risk Management within FHA. There is still significant work that needs to be done to fully integrate the office and its activities into the ongoing operations of FHA. Mr. Ryan will continue to assist in this area during a transition to a new Deputy Assistant Secretary for Risk Management. We are currently moving forward in the process of evaluating candidates for that position and hope to announce the individual selected to lead this Office in the near future.

Under this Administration, FHA has engaged in a comprehensive effort to strengthen its risk management capabilities and processes to ensure the ongoing health of its insurance funds. We've strengthened credit and risk controls – toughening requirements on our Streamlined Refinance program, making several improvements to the appraisal process and condominium policies, and implementing a two-step credit score policy. At the same time, we've significantly increased our lender enforcement efforts to protect both our insurance funds and consumers. We are very grateful for the support that Congress has provided with our efforts to reduce fraud and risk. Through the $20 million Combating Mortgage Fraud funds that Congress granted HUD in FY2010, we have begun to implement several risk management and systems modernization reforms to incorporate modern risk and fraud tools and counterparty data consolidation. We look forward to continuing to work closely with Congress on all of these issues, and to further reduce risks to the American taxpayer.

In response to an increase in FHA insurance volume and the overall need to ensure proper risk management FHA's Multi-Family and Healthcare program offices have taken a number of steps to protect ourselves from emerging risks and retain the program's solvency. In an effort to decrease claims and save taxpayer dollars, we have imbedded risk management in all of our programs and processes. For example:

- We have tightened FHA lender approval and capital requirements.
- We enhanced oversight and monitoring of FHA lenders, and instituted a number of risk mitigation measures and guidance including: new loan closing documents for the first time in 40 years, a revised MAP Guide that compiles all relevant lender guidance that has been published by FHA, developed underwriter qualification standards, enhanced verification of property financial performance, expanded borrower mortgage credit analysis.
- We developed new credit policies and hold monthly reviews of the portfolio performance and of the new production data.
- We established a National Loan Committee, in addition to local committees to gain consensus on high dollar loans.

As important as FHA is at this moment to our nation's economy, it has not been immune to the larger housing recession. In November of 2010, for the second year, we reported to Congress that FHA's single-family capital ratio was below the required two percent level – at 0.50 percent of total insurance-in-force. That was a direct result of moving funds from the Capital Reserve Account to the Financing Account over a period of several years, and in anticipation of high net claim losses in the future, primarily on loans originated in FY2007 – FY2008. At the end of FY 2010, the Financing Account held nearly $29 billion, representing an additional 3.1 percent of insurance-in-force in addition to the $3.9 billion in the Capital Reserve Account, making total reserves held by FHA 3.6 percent of insurance-in-force.

The very large and strong FY 2009 and FY 2010 books-of-business are helping stabilize the MMI Fund in the face of high losses on the FY2006 to FY 2008 books. Our actions to raise single-family insurance premiums three times over the past 16 months—plus one large increase for HECM loans—are also providing revenues that will substantially offset expected future losses on earlier books. I would like to express my appreciation for this committee for helping pass legislation in the last congress that gave us the flexibility to raise our premiums. Credit quality on new endorsements is historically high, so that expected net credit costs on the FY 2010 and FY 2011 book are low while expected premium revenues are very high. As noted in our most recently released Quarterly Report to Congress on the MMI Fund, strong expected performance on new endorsements is also indicated by:

- The share of borrowers with credit scores of 620 or higher was 97.2 percent for the quarter; only 2.8 percent of borrowers had credit scores below 620. In contrast, 50.4 percent of borrowers had credit scores below 620 during the first quarter of 2008. The percentage of borrowers with credit scores of 720 or higher also continues to rise and is more than four times the level seen in the first quarter of 2008.

- In this quarter, 24.4 percent of all newly endorsed, fully-underwritten loans had LTVs below 90 percent. This is almost 10 percentage points greater than the 2008 Q4 low of 15.8% and also reflects a trend over the past ten years of fully-underwritten (non-streamline) refinance loans becoming more of a core component of FHA's insurance activity.

- The serious delinquency rate for the single-family portfolio at the end of Q2 2011 is 8.31 percent. This is substantially lower than the 9.05 percent rate observed one year earlier. Although the seasonally adjusted series (currently at 8.34 percent) rose slightly from the previous quarter, it is still trending downward over the longer horizon.

- Although the early-period delinquency rate rose a marginal 0.02% in the recent period, the overall quality of newly originated FHA loans, as measured by early-period delinquency rates, continues to be significantly stronger than historical levels. The much improved early delinquency rates are an indication that the FY2010 book should perform substantially better than did the FY 2009 book, which itself is performing substantially better than have the FY2007 and FY 2008 books.

We will present the upcoming FY2011 findings to the Congress in our full report scheduled for this coming November.

Ensuring Responsible Access to Credit and Liquidity

The past two and a half years that I have been at HUD have been a truly historic period for FHA. Most of the attention has been focused on our single family loan guarantee programs that became a crucial source of liquidity while the nation endured perhaps the most severe housing market downturns in its history and a virtual collapse of commercial home mortgage financing. FHA-insured lending went from under 3% of the market to as much as 30%, fulfilling its key countercyclical function of providing liquidity and stability amid distressed market conditions. FHA financing was instrumental in preserving homes and offering new ownership opportunities for millions of American families. And while FHA was not immune to the adverse financial effects of a record decline in home prices and a prolonged economic recession, it nonetheless has been able to continue to perform its crucial functions while maintaining a healthy balance sheet.

Perhaps less heralded, but no less important, has been the role that FHA has played in providing critical liquidity for multifamily developments, nursing homes, assisted living properties and hospitals. FHA's multifamily and healthcare programs are a critical component of the Department's efforts to meet the nation's needs for decent, safe and affordable housing. These sectors faced a severe contraction in the availability of conventional financing, as well as a near collapse of the tax exempt bond market. Driven by the constriction in the conventional mortgage market and improvements in HUD business operations, demand for FHA loan insurance for multifamily and healthcare programs has increased dramatically in the last 3 years. Mortgage commitment issuances rose from $4.3 billion in fiscal year 2008 to $16.2 billion in 2010. FHA's insured portfolio of Multifamily and Healthcare stands at $61 billion, with $16.5 billion in the application pipeline. FHA's prominent role in the multifamily and healthcare lending markets is anticipated to moderate but still continue in fiscal years 2012 and 2013.

Amid such growth for FHA multifamily and healthcare programs, FHA has been hard pressed to keep pace with the demand. Since 2008, firm commitments issued in FHA's multifamily programs have increased 197% while the number of FHA field staff has decreased considerably. Not surprisingly, processing times have increased as well. FHA's healthcare lending programs have faced similar difficulties. To identify opportunities to address these challenges and improve performance we started a comprehensive business re-engineering process. This process has concluded, been piloted in one of our Hubs, and rolled out to our field leadership. The re-engineering process focused on strengthening the way we manage through implementation of performance dialogues to establish and assess achievement toward targets; optimizing review processes and enhancing employee skills; and strengthening risk management through underwriting discipline and greater risk oversight. We look forward to further process improvements as these initiatives continue to develop.

In the current fiscal year, FHA under its General Insurance Fund has issued commitments exceeding $13 billion and will likely end the year with a total of about $17 billion in new multifamily and healthcare loan guarantees. FHA estimates that this new business will generate premium income and other receipts that exceed net costs by between $400 to $500 million.

Going forward, FHA is continuing to examine its business models and practices, with an eye towards continuing to improve its risk management capabilities while expediting processing and approval timelines. These efforts will further enable FHA to facilitate the availability of affordable housing in a responsible manner.

Even more significant than the positive impact FHA's multifamily and healthcare programs have on FHA's insurance funds is the impact that they have on their communities. In addition to providing needed care, healthcare facilities are community anchors, major employers, and contributors to quality of life. These institutions serve as strong economic engines for the regions in which they are located. Similarly, multifamily projects have significant impact on communities by expanding affordable housing options, spurring economic development activity, and creating jobs.
Using the widely respected IMPLAN economic model, FHA calculated the economic benefits for all hospitals and healthcare facilities that received mortgage insurance commitments in FY 2010. FHA issued insurance commitments for 58 hospital and residential care facilities in FY 2010. These projects are estimated to have created more than 38,000 new jobs, and yielded $4.3 billion in overall economic benefit during construction and an additional $2.5 billion in new economic activity annually.
Employing the same economic model, FHA estimates that the $3.78 billion of multifamily new construction loans endorsed by FHA in FY 2010 directly created 30,000 jobs and supported the creation of 45,000 additional indirect or induced jobs. In total, FHA-insured multifamily projects yielded approximately 75,000 jobs throughout the nation. Clearly, FHA's multifamily and healthcare new construction insurance programs offer much more than just financing for large projects – they create jobs and improve the quality of life in communities nationwide.

As FHA's multifamily and healthcare portfolios have grown, HUD has taken a number of steps to improve its risk management in these programs. FHA's lender approval and capital requirements have been strengthened and the oversight and monitoring of FHA-approved lenders has been enhanced. In addition, we have made changes to our underwriting and credit evaluation requirements, including revised underwriting standards, improved verification of property financial performance, and expanded borrower mortgage credit analysis. Finally, a loan committee approval structure has been established to better assess and analyze loans and their attendant risks prior to issuing a commitment.

History and Performance of FHA Healthcare Programs
The Subcommittee has also requested that I explain the rationale for FHA's participation in healthcare lending. FHA received authority to insure hospital loans in 1968, when Section 242 mortgage insurance for hospitals was enacted. Section 232 mortgage insurance for residential care facilities (nursing, assisted living, and board-and-care facilities) dates from 1959. FHA's Office of Healthcare Programs (OHP) administers both programs. Since the inception of these programs, nearly 400 mortgage insurance commitments have been issued for hospitals, totaling $15.6 billion, and over 4,000 mortgage insurance commitments have been issued through the Section 232 program, totaling $16 billion.

As is clear from the figures above, FHA has long been a significant source of mortgage financing for healthcare facilities.

Amid the recent economic downturn facing the nation, FHA's role in these markets has become even more prominent. In today's difficult financial environment, the traditional sources of capital for the financing of healthcare facilities have either diminished or become more risky. Compared to the alternatives, the long term, fixed interest rate products offered by FHA have become an attractive choice for many hospitals and residential care facilities. The availability of fixed rate, long-term FHA financing lowers the cost of capital for these facilities and therefore reduces the costs of the Medicare and Medicaid programs by lowering the cost of care.

Prudent underwriting and proactive monitoring and intervention when a healthcare facility becomes troubled have ensured that both programs yield a profit for the General Insurance Fund. The credit subsidy rates for FY11 and FY12 are negative and improving:

Program	**2011**	**2012**
Sec. 242 Hospitals	-3.67	-3.82
Sec. 232 Refinance	-1.54	-1.96
Sec. 232 New Construction/Rehab	-0.71	-1.34

In addition to a negative and improving credit subsidy rate, claim rates for these programs have remained stable at very low levels. For the past several years, claim rates for the 232 and 242 programs have been at or around 1%.

Critical Access Hospitals

I would also like to highlight the role that FHA plays in providing mortgage insurance for critical access hospitals in rural communities. The Section 242 program provides mortgage insurance for hospitals across the country, including 25 Critical Access Hospitals (CAHs) in rural communities. Critical Access Hospitals are small facilities that serve as the focal point of health care in remote, rural communities and, often, are the only source of emergency care in large geographical areas. Critical access hospitals meet all of FHA's financial eligibility criteria but may provide a slightly different offering of medical services than a traditional Section 242 eligible hospital. Critical Access Hospitals are approved by their respective licensing board because travel is difficult, and sometimes impossible, due to the terrain, weather and distance to other hospitals. Additionally, a critical access hospital – as the largest employer - is the "economic engine" for a region. In the past three years, the Critical Access Hospital projects supported by FHA mortgage insurance are estimated to have generated more than $1.1 billion in economic activity during construction and $246 million annually post-construction in their regions. We are appreciative of the Congress' long standing support for Critical Access Hospitals by amending Section 242 to permit these important facilities to be eligible for FHA insurance. This amendment expired July 31, 2011, and without action to once again extend Section 242 no additional Critical Access Hospitals will be eligible for FHA insurance. We are grateful to Rep. Hinojosa for introducing H.R. 2573, the Rural Health Care Capital Access Act of 2011, and to Senator Kohl for sponsoring companion legislation (S.1431, cosponsored by Senators Conrad, Johanns, Johnson, Roberts, Tester and Thune), which would provide this important extension for five additional years.

I look forward to working with Members of this Subcommittee to enable this important program to continue operating at no cost to taxpayers. In fact, these hospitals have contributed to the net receipts to the Treasury generated by the hospital portfolio, as discussed above

COMMENTS ON DISCUSSION DRAFT OF FHA, RHS, AND GINNIE MAE LEGISLATION

I appreciate the opportunity to share our current thoughts on the initial discussion draft developed by the Subcommittee. HUD shares the Subcommittee's goal of further strengthening FHA and welcomes the opportunity to work with Congress to increase access to credit, and strengthen risk management and lender enforcement. Many elements of this discussion draft are similar to H.R. 5072 in the 111th Congress, which passed the full House of Representatives 406-4 and was supported by the Administration. We appreciate the support of many members of the Committee for the introduction and passage of this bill. In particular, I would like to call your attention the following provisions:

Increasing Access to Credit by Supporting Small Lending Institutions. The FHA Reform Act provision dealing with third party loan originators has a direct impact on the ability of small lending institutions, including community banks that are not FHA-approved Direct Endorsement lenders, to participate in FHA programs. In an effort to better focus its oversight and risk management resources, FHA issued a regulatory change in April of 2010 whereby as of January 1, 2011, those entities that formerly participated in FHA programs as loan correspondents are no longer be able to close FHA loans that they have originated in their own names. So, while these entities are still be able to participate in the FHA program, without a statutory change they are required to close FHA loans in the name of the FHA-approved lender that sponsored and underwrote the loan. For such institutions, maintaining their brand with the consumer is of utmost importance, and closing loans in their name is crucial to this endeavor. An unintended consequence of the April, 2010 regulatory change is that ultimately, the inability to close FHA loans in their own name can adversely affect many small institutions, perhaps prompting them to choose not to originate FHA loans at all. This, in turn, can further constrict access to mortgage credit for consumers who do not have access to major lenders.

HUD strongly supports this provision. Permitting small lending institutions to continue offering FHA loan products is vital to ensuring the availability of mortgage credit nationwide, particularly for underserved communities. This provision is a reasonable and appropriate means to assist borrowers and small lenders without posing any additional risk to FHA.

Indemnification by FHA Mortgagees. Additionally, HUD is seeking Congressional authority to extend FHA's ability to hold all lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated and for which the error may have impacted the original loan decision, or in which fraud or misrepresentation were involved. FHA currently has this authority for loans originated through the Lender Insured (LI) process, which accounts for 70 percent of FHA loan volume, but only 29 percent of FHA-approved lenders.

FHA is asking that Congress grant explicit authority to require indemnification for loans that were improperly originated for the remaining 71 percent of FHA-approved lenders. Such authority would permit FHA to hold all underwriting lenders to the same standard by expanding the application of existing authority to other sources of counterparty risk.

Authority to Terminate FHA Mortgagee Origination and Underwriting Authority. HUD also seeks expanded authority to terminate the origination and/or underwriting authority of FHA-approved mortgagees. Via the Department's Credit Watch Termination Initiative (Credit Watch), FHA conducts quarterly evaluations of the origination and underwriting performance of FHA-approved lenders. Through this program, lenders with excessive default and claim rates compared to other lenders in the same HUD field office jurisdiction may have their origination or underwriting approval terminated for a period of six months. Since the creation of the Credit Watch Termination Initiative in 1999, FHA has terminated the origination or underwriting approval of 563 lender branches.
At present, FHA may only terminate a lender's authority in a specific HUD field office jurisdiction. The provision of the proposed legislation dealing with FHA's authority to terminate lenders would remove the current jurisdictional limitations and would permit the Department to take action to prevent irresponsible lenders from conducting FHA business in the specific geographic areas where their activities pose a threat to FHA and its insurance funds.

As an example, for a lender that operates throughout Texas, while FHA may terminate the lender's authority in the Fort Worth field office jurisdiction via Credit Watch due to excessive default and claim rates, the Department would have to terminate the lender's operations in the Dallas field office jurisdiction through a separate Credit Watch action. Limiting HUD's Credit Watch activities to field office jurisdictions prevents the Department from taking quick action to terminate poorly performing lenders in larger areas. Often, a lender's poor origination or underwriting performance is visible initially through excessive defaults and claims in a particular area, but over time grows to include all of the areas in which a lender operates. In the example above, were FHA granted the expanded authority it is seeking, the Department would be able to terminate the origination or underwriting authority of the Texas lender throughout the entire state, or even nationwide, if the lender's performance warranted such action.

While we are very supportive of the provisions discussed above, we would like to share our concerns with the following provisions:

GI/SRI Capital Reserve. As discussed above, the General Insurance / Special Risk Insurance (GI/SRI) funds provide financing for the FHA multifamily and healthcare loan guarantee programs and several very small specialized loan products. These accounts also continue to hold a sizable portfolio of single family loan guarantees (HECM, condominium, and rehabilitation loans) insured prior to FY 2009 when responsibility for new lending under these programs was transferred to the Mutual Mortgage Insurance Fund.

The Special Risk Insurance Fund exists almost entirely to handle the financing of subsidized loans made many years ago. The largest components are the Sec. 235 and 236 programs that were discontinued in the 1970s, although refinancing of those old FHA loans remain in this fund.

New lending under these legacy programs have almost all been terminated, and the limited volume of current activity is inconsequential.

The legislative discussion draft proposes the creation of separate capital reserve requirements, similar to the MMI capital reserve requirement, for the GI and SRI funds beyond their current statutory requirement to operate under Federal Credit Reform. While we share the goal of insuring that taxpayers are not exposed to unnecessary risk in the GI and SRI funds, the creation of a single new capital reserve requirement as structured in the discussion draft for these funds would not be feasible given the very different nature and operations of programs in the GI/SRI accounts. Additionally, as currently drafted, the legislation could require that HUD raise premiums on new multifamily and healthcare lending (the major active programs) in order to generate surplus capital to hold against existing portfolios of HECMs and inactive legacy programs. Further, because HUD has been running these programs with negative credit subsidy for many years, any new capital requirements would not recognize the substantial capital produced by receipts that HUD has paid to the Treasury on outstanding cohorts.

However, we are happy to work with Congress to develop more appropriate reporting benchmarks and/or other performance metrics to provide greater transparency into the performance of loans guaranteed in the GI and SRI funds. For instance, establishing metrics for loans originated in a prospective fashion is one possibility that could make benchmarking more feasible and reflect the current negative subsidy of the GI/SRI funds while accounting for the nuances associated with legacy portfolios residing in the funds.

Minimum Downpayment Guidelines for Single-Family Insurance. As currently structured in the discussion draft, we disagree with the proposal to increase the minimum down payment for all FHA borrowers to five percent. We believe it is essential for HUD to retain the flexibility to respond to market and loan performance conditions rather than being locked into a specific down payment structure. After extensive evaluation we have determined that such a proposal would adversely impact the housing market recovery and restrict access to credit for worthy borrowers.

A fundamental part of FHA's mission is to assist first-time homebuyers, who still make up 80 percent of all home-purchase loans insured by FHA. These households tend to have low levels of wealth, but that does not mean they are not credit worthy. Our analysis shows that, were a 5-percent down payment required during this past year, 345,000 families could have been shut out of the opportunity to become homeowners. That represents 40 percent of all FHA-insured homebuyers, and a significant portion of the overall housing market. This could result in forestalling the recovery of the housing market potentially leading to a double-dip in housing prices by significantly curtailing demand.

Furthermore, downpayment alone is not the only factor that influences loan performance. Loan underwriting requires a balancing of risk factors rather than a reliance upon any one factor. For example, the combination of downpayment and FICO score is a much better predictor of loan performance than just one of those components alone. For instance, loans with a loan-to-value (LTV) above 95% <u>and</u> a FICO score above 580 perform better than loans with LTV below 95% <u>and</u> a FICO score below 580, while loans with a LTV above 95% <u>and</u> a FICO score below 580 perform significantly worse than all other groups, as illustrated below.

FHA Single Family Insured Loan Claim Rates
Relative Experience by Loan-to-Value and Credit Score Values[1] - Ratios of each Combination's Claim Rateto that of the Lowest Risk Cell[2]

Loan-to-Value Ratio Ranges	Credit Score Ranges[3]			
	500-579	580-619	620-679	680-850
Up to 90%	2.6	2.5	1.9	1.0
90.1 - 95%	5.9	4.7	3.8	1.7
Above 95%	8.2	5.6	3.5	1.5

Source: US Department of HUD/FHA; March 2010.

It is for these reasons, rooted in a thorough review of actual FHA loan performance data, that HUD imposed FICO floors tied to downpayment rates, and realigned the premium structure to rely less upon the upfront premium—which is financed into the loan balance—and more on the annual premium—which is paid monthly by the borrower.

Transfer of Rural Housing Programs to HUD from USDA. Finally, I would like to address the proposal to transfer the administration and operations of Rural Housing programs to HUD from the Department of Agriculture. During this Administration, we have worked together very closely to align the agencies' rental programs through a White House Rental Policy Working Group that includes HUD, USDA, and Treasury. Through this group, we have begun with a benchmarking exercise for loan guarantee programs, as well as discussed policy issues such as whether the current programs serve distinct constituencies and purposes or whether there is significant overlap. Additionally, we have begun working toward the creation of a similar task force that also includes the Department of Veterans Affairs, to identify broader strategies to align housing policy throughout all government housing programs. Given the ongoing and initial stages of these various collaborations, we believe it makes sense to continue focusing for now on those efforts, rather than contemplating a more extensive reordering of the various federal agencies' roles in these programs, as outlined in the legislation.

CONCLUSION

Madam Chair and Ranking Member Gutierrez, strengthening the FHA won't solve all of our housing challenges – which is one reason the Administration is working to produce a more balanced, comprehensive national housing policy that supports homeownership and rental housing alike, providing people with the options they need to make good choices for their families.

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[1] Based on experience of the FY 2005 – FY 2008 insurance cohorts, as of February 28, 2010. These ratios represent averages of the cell-level ratios in each cohort.
[2] Claim rates in the first row and last column are the low-risk cell and are represented by a ratio value of 1.00. Values in all other cells of this table are ratios of the cell-level claim rate to the claim rate of the low-risk group.
[3] Loan-level scores represent the decision FICO scores used for loan underwriting. This analysis includes all fully-underwritten loans, purchase and refinance, but excludes streamline refinance loans.

Further, as important as the FHA is at this moment, I want to emphasize that the elevated role it is playing is temporary – a bridge to economic recovery helping to ensure that mortgage financing remains available until private capital returns.

That means that while we must remain mindful that qualified, responsible families need to continue to be able to purchase a home, the changes and legislative requests that we have announced are crafted to ensure that FHA 1) appropriately manages its business as it plays an elevated role in the market at present, and 2) is able to step back to facilitate the return of the private sector as soon as possible. Until private entities can and will supply necessary levels of mortgage capital on their own, they need the FHA – and so does our housing market.

So, Chairman Biggert, while FHA must remain a key source of safe mortgage financing at a critical moment in our country's history, we recognize the risks that we face and the challenges of this temporary role that we play in today's market. And the bottom line is this: for the sake of both borrowers and American taxpayers, the loans that FHA insures must be safe and self-sustaining over the long-term. The Administration is committed to ensuring that they are – today and into the future. Thank you for the opportunity to testify. I would be pleased to answer any questions the members of the subcommittee may have.

Testimony of

Senator Johnny Isakson

Before The

House Financial Services Subcommittee on

Insurance, Housing & Community Opportunity

On the Topic Of

QRM & Implications for FHA Reform

Thursday, September 8, 2011

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the kind invitation to return to the House where I was fortunate to serve alongside so many of you when I first came to Congress in January 1999. Before coming to Congress, I worked in the residential real estate industry for 33 years, and now as a policy maker, I welcome every opportunity to work on issues relating to housing finance and sustainable homeownership.

You have asked me to testify today on the implications of the proposed Qualified Residential Mortgage ("QRM") regulations implementing Section 941 of Dodd-Frank for the FHA's market share and our collective efforts to restore a healthy and vibrant private market as the primary source of home financing. Last summer, during the consideration of Dodd-Frank, I joined with Senators Mary Landrieu and Kay Hagan to sponsor the QRM language, and today I remain very confident that this provision will play a very key and integral role in attracting private capital back to United States housing finance and restoring FHA to its smaller, historical role in the market.

Before I begin, however, I want to pause and underscore the important the work of this Subcommittee, given the current condition of the United States housing

economy. A couple of weeks ago, a CEO from a completely different business sector told me this economy will turn only when housing begins to turn, not before.

As we sit here today, there have been some 5 million foreclosures nationwide over the last 5 years. The volume of REO inventory continues to stack up at Fannie Mae (153,224), Freddie Mac (65,174) and the FHA (68,997), not to mention at volume in private label securities and on bank balance sheets. Another 4 million loans are in some state of delinquency – 3.2 million of the 4 million are beyond six months late on payments. These numbers ignore another pressing problem across our country – homes with negative equity that – in many cases -- will take a lifetime to recover. A recent survey of CoreLogic data found that among U.S. homeowners with mortgages, 52 percent – 24.8 million homeowners – have less than 25 percent equity in their homes. Negative equity has a chilling impact on the ability of households to move for a new job, retirement or an expanding family, and makes it impossible for many others to refinance into today's lower interest rates.

While there is plenty of blame to go around on how we got to this point, I want to highlight two practices or problems that I believe are most to blame: poor underwriting and bad loan products.

Years ago when I sold real estate in Atlanta, Georgia, lenders could not take short cuts in underwriting. Loans were fully documented, income and debt obligations of the borrowers were fully verified, and properties were accurately appraised. We've learned powerful lessons through this cycle that we all pay for shortcuts in underwriting processes.

We have also learned that while there were some loan products that were appropriate for a very narrow set of sophisticated borrowers, these products were overwhelmingly inappropriate for most borrowers. Products like negative amortizing mortgages, interest-only mortgages, short term ARMs spelled disaster for first time buyers and those with modest incomes, weaker credit or limited cash reserves. Poor underwriting and risky products had much to do with the corrosion of mortgage securitization through the cycle, and if regulators had controlled just these two factors through this last cycle, we would be a far different place today. That is where the Qualified Residential Mortgage comes in. Last year, when the concept of risk retention was first put on the table by then-Chairman Barney Frank and added to the House-version of Dodd-Frank, the intent was to strengthen asset securitization by forcing more underwriting scrutiny at the closing table between the lender and the borrower.

When the House-passed bill came over to the other side of the Capitol, Senators Landrieu, Hagan and I understood that applying risk retention to safe, stable products and well-underwritten loans could unnecessarily raise costs for responsible, creditworthy borrowers. That is why we sought to improve the risk retention provision by creating strong incentives for borrowers, lenders and investors to seek out well-underwritten, sustainable mortgages.

Our concept was to provide for an exception to the 5% risk retention for high quality residential mortgages with underwriting and with product features that historical data prove have a reduced risk of default. A standards-based approach would incent high quality lending and borrowing without the higher costs, while risk retention would be targeted to risky lending behavior.

Our QRM standard included full documentation, consideration of monthly debt to income ratios, protection from mortgage payment shock, restrictions on risky product types (no negative amortization mortgages, no interest-only mortgages, or other unstable features), and for loans with less than 20% down payments, mortgage insurance or other credit enhancements obtained at the time of origination to the extent they reduce the risk of default.

Unfortunately, the regulators, in their Notice of Proposed Rulemaking, have narrowly interpreted the QRM exception to the point where it will never attract

sufficient mortgage origination to support a new asset classification for securitization.

I have very specific concerns with the regulators' narrow interpretation of the QRM provision in Section 941 in their March 31, 2011 Notice of Proposed Rulemaking:

- First, Congress never included a down payment component to the QRM elements. That is not to say that I do not think there should be some level of down payment. In fact, I think a 5% down payment is the right number for the QRM securitization standard. Regrettably, the NPR sharply narrows the QRM with a required 20% down payment and very restrictive payment-to-income restrictions.
- Second, I have heard from more than one of the Risk Retention regulators that the Congress intended for the QRM standard to be a very narrow exception to the risk retention rule. Nothing could be further from the truth. In fact, the only "sizing" or limitation on the scope of QRM was expressly added in conference, and that limitation specifically says that the QRM shall be defined as "no broader than the definition of 'qualified mortgage'" in Title 14 of Dodd-Frank. Instead, the regulators have turned the QRM on its head in order preserve a vibrant *non-QRM* market – which is, frankly,

backwards. For housing to be restored to solid ground, we want to see a large and vibrant *QRM* market, not the other way around. Regulators should write the standard as Congress intended, and let the market – not Congress or the regulators – determine the relative size of the market for a new, high quality QRM mortgage security.

- Third, and most importantly for our purposes of today's hearing, the narrowly proposed QRM rule will have serious and adverse consequences for the FHA program and for our collective efforts to restore fully private capital as the primary source of mortgage credit in the market. Today, virtually all high LTV lending is being done by the FHA. The loan level price adjustments charged by Fannie Mae and Freddie Mac for all high LTV lending discourages conforming origination in those categories. The average loan purchased by Fannie and Freddie today has a 69% LTV and a 760 FICO score – standards that exclude many responsible borrowers from the conventional market. Moreover, Dodd-Frank exempts the FHA from risk retention altogether. That means that if safe high LTV conventional lending is not also included in the QRM standard, FHA will be the only option available for consumers without a sizeable down payment. We want private capital to be able to compete in all the corners of the mortgage market with well-underwritten, safe and stable mortgages. To do that, the

> QRM market needs to be able to serve the many creditworthy low down payment borrowers who have long been the cornerstone of a strong U.S. housing market.

With the current condition of our United States housing economy, we need to encourage prudent, safe lending – including responsible high LTV lending – which has been a significant part of the mortgage finance system for decades. An unnecessarily narrow QRM does far more harm than good in helping reset strong, transparent standards for conventional lending and private mortgage securitization. The thirty year, fixed rate mortgage is the safest mortgage product in the market. I leave you with this question, if we are stuck with the NPR as it is proposed today where few mortgages qualify for the exemption from risk retention, what will a commercial bank do with its mortgage lending business: (1) hold all 30 year mortgages on their balance sheet and incur significant interest rate risk; (2) sell the fixed rate mortgages into the secondary market and incur the cost of risk retention, which will be passed down to the borrower; (3) offer only shorter term adjustable rate mortgage products, or (4) scale back or leave the mortgage business altogether? None of these are palatable options, and none are good for consumers or for the recovery of the housing market.

The QRM as proposed on March 31st, should be re-aligned to the intent of Congress and re-proposed on an expedited basis. The standard has huge implications for the FHA program, and more importantly for the recovery of private capital in our nation's system of housing finance. The regulators need to get this one right.

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

Written Testimony of Ted Tozer
President, Ginnie Mae
U.S. Department of Housing and Urban Development

"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets, Part 2"

Hearing before the House Committee on Financial Services' Subcommittee on Insurance, Housing and Community Opportunity
Thursday, September 8, 2011

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss the future role of Ginnie Mae in the housing market. My name is Ted Tozer, and I am the President of Ginnie Mae. I have been in the housing finance industry for more than 30 years. For more than 25 years, I worked with mortgage-backed securities (MBS), serving as the Senior Vice President of Capital Markets for the National City Mortgage Company. At National City, I managed loan pricing, sales, and delivery and pipeline risk hedging. Securitizing loans with Ginnie Mae was an important part of our business at National City; at times during my tenure, National City was one of Ginnie Mae's top five Issuers. I worked with the corporation extensively and developed a deep appreciation for its role in housing finance.

Further, serving as President of Ginnie Mae during the past year and a half has enhanced that appreciation and increased my understanding of the unique contribution Ginnie Mae makes to financing affordable housing. The corporation is charged with ensuring that adequate capital is available for financing affordable single-family homes and rental housing and with providing liquidity in times of economic stress. The recent financial crisis has highlighted for all of us the importance of having a public utility that continues to finance loans when the private market retreats. That is the role of Ginnie Mae; and it is a role that, due to the housing crisis, Ginnie Mae has been called on recently to perform in a more robust manner than ever before.

A Stabilizing Force

As you know, we remain embroiled in the worst housing crisis this nation has endured since the Great Depression. By January 2009, we had experienced 30 straight months of housing price declines, $6 trillion in home equity had been lost, and we were at the midpoint of what would become 22 straight months of job loss.

Congress and the Administration launched a myriad of efforts to stabilize our economy. Loan limits were raised, the Federal Reserve purchased $1.4 trillion in MBS, first-time homebuyers were offered a tax credit, and programs were launched to help homeowners avoid foreclosure.

Although not every initiative was as successful as we might have hoped, as a whole these efforts have made a positive difference. Though still fragile, our housing market and economy are recovering. Although job creation has slowed since May, private-sector payrolls increased at an average rate of about 180,000[1] per month over the first five months of this year, our MBS markets—with significant government support—still function, and more than 10 million[2] families have saved money through refinancing and loan modifications.

Congress and the Administration acted quickly and courageously to strengthen credit markets, stabilize housing prices, and spur job creation. In addition to the actions outlined above, we were able to reduce the impact of this crisis because Ginnie Mae and the Federal Housing Administration (FHA) made it possible for banks and mortgage companies to continue mortgage lending. By providing an outlet for the sale of government-insured products, Ginnie Mae helped stem the tide of economic upheaval that began in 2008, and it has been an essential element of the nation's recovery efforts since then.

How Ginnie Mae Stepped In

During this crisis, Ginnie Mae has provided about $1.2 trillion in capital for mortgages, which has financed more than 4.4 million single-family homes and nearly half a million multifamily units. Our multifamily properties include apartment buildings, acute care hospitals, nursing homes, and assisted living facilities. The financing we provide health care facilities helps many communities maintain much needed health care options for elderly and infirm residents. Also, building a new hospital can have a positive and significant impact on the economy of a small community. In April 2009, a Ginnie Mae MBS was used to finance a hospital in New Jersey. The hospital is creating 4,700 jobs during the construction phase, and upon completion, 2,200 permanent jobs will remain.

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[1] Chairman Bernanke's June 7, 2011, speech on the economy at the International Monetary Conference in Atlanta.
[2] Administration score card, June 2011

Overall, Ginnie Mae's support of the housing market has been significant. In July 2010, the outstanding balance of our securities topped $1 trillion and now stands at nearly $1.2 trillion. It is the largest outstanding balance in the organization's history. Shortly after the crisis began, in October and November of 2008, Ginnie Mae's market share reached 40 percent.[3] For those months when credit markets were in disarray, lenders shifted nearly 40 percent of their business to Ginnie Mae. At the height of the financial crisis, lenders turned to Ginnie Mae to access capital, and we stepped up our efforts to manage the tremendous volume increase, ensuring that lenders would continue to be able to finance homes.

Lenders were able to access capital through Ginnie Mae MBS because investors highly value our securities. Investors continued to purchase the securities throughout the crisis, providing low cost financing for borrowers using government programs. To achieve the same low rates in the conventional market, the Federal Reserve purchased large amounts of GSE securities. Because of the confidence investors have in Ginnie Mae securities, intervention of the same magnitude was not necessary for the Ginnie Mae program. In fact, Ginnie Mae has weathered this crisis without requesting federal support of any kind.

Our performance is notable given that, just prior to the crisis, Ginnie Mae's market share was less than five percent. The small market share provoked discussions among policy makers about whether the corporation was truly necessary. It is now clear that an entity such as Ginnie Mae is an essential part of a well-functioning housing finance system, especially in times of economic stress.

The Role We Are Playing Now

Ginnie Mae MBS finances 99 percent of all mortgages insured by government agencies. FHA, the Department of Veterans Affairs (VA), and the United States Department of Agriculture's Rural Housing Service (RHS) create programs targeted to specific borrowers. Ginnie Mae MBS finances the loans insured or guaranteed by those programs. By insuring or guaranteeing these loans, these agencies provide credit enhancement. By guaranteeing payments to security holders, Ginnie Mae ensures that a consistent pool of funding is available for government-insured or guaranteed mortgages.

For more than 40 years, the corporation has served as the principal financing arm for government mortgage products, ensuring that money flows into the domestic housing market. The capital raised by Ginnie Mae MBS serves a variety of Americans. It is especially helpful to low and moderate income families, first-time homebuyers, and minorities.

[3] According to Inside Mortgage Finance, Ginnie Mae's share of the MBS market reached 40 percent in October 2008, November 2008, and January 2009.

Minorities make up a large share of the Ginnie Mae market. According to the 2009 HUMDA data, 81 percent of homes purchased by African Americans and 73 percent of homes purchased by Hispanic Americans were financed by Ginnie Mae with loans backed by FHA, VA, or RHS. Due to our organization, there will always be a consistent flow of low cost funding from the capital markets for financing homes for American families.

Public-Private Partnership

Meeting the needs of prospective homeowners would not be possible without the participation of investors. Private investors worldwide purchase FHA, VA, and RHS loans in the form of Ginnie Mae securities. Partnering with investors and lenders, Ginnie Mae leverages private capital to make homeownership possible. These investors eagerly purchase Ginnie Mae securities. In fact, Ginnie Mae securities currently trade at a premium relative to Fannie Mae and Freddie Mac securities. Without us, there would be limited funds for lenders across the country to originate government-insured products, and it would be far more difficult for borrowers to obtain FHA, VA, and RHS loans.

Investors purchase Ginnie Mae securities in what is known as the To-Be-Announced (TBA)[4] market. This large (trillions of dollars), highly liquid, forward trading market in MBS may be one of the most important benefits Ginnie Mae's public-private partnership model has brought to America's housing finance system and homeownership. As you know, Ginnie Mae created the first MBS, and it was the need—identified by securities dealers—to establish standards for the trading and settlement of Ginnie Mae bonds that spurred the development of the TBA market. Now, of course, the TBA market includes all agency securities.

The TBA market defines parameters under which mortgage pools can be bought and sold. The standardization in this market allows lenders to pre-sell loans in securities even though the exact characteristics of the securities may not be explicitly known at the time a trade is initiated. The homogenous nature of agency securities and the government guaranty allows billions of dollars in MBS to be traded in TBA markets every day. TBA markets serve as the benchmark for pricing in all MBS markets—that is non-agency MBS are priced relative to agency MBS. Forward trading in these markets allows borrowers to "lock" rates on mortgages, and the vast liquidity in TBA markets creates efficiencies that give lenders consistent access to capital. Effectively recycling capital allows lenders to finance 30-year fixed rate mortgages at reasonable rates for borrowers.

[4] To-Be-Announced (TBA) – To-Be-Announced trading is a trading convention whereby homogeneous MBS are traded for forward settlement, and the purchasing party does not know the specific identity of the MBS pool to be delivered. Trades are executed based on a limited number of criteria, including Issuer, coupon, term of mortgage collateral, and settlement date.

According to the Securities Industry and Financial Markets Association (SIFMA), $4 trillion in bonds are eligible for trading in TBA markets. Federal Reserve estimates show the average daily trading volume of agency MBS to be approximately $300 billion. TBA markets have clearly evolved beyond the original goal of establishing trading and settlement standards for Ginnie Mae securities, but in part, we can thank Ginnie Mae for spurring the development of a market that has become a crucial element of our housing finance system.

Corporate Performance

Ginnie Mae serves as an excellent example of smart and efficient government. Through our organization, the U.S. government attracts private capital into the U.S. housing market and finances government-insured products without raising the national debt and while minimizing taxpayer risk exposure. Ginnie Mae is very efficient; its small staff of 85 employees manages a portfolio of approximately $1.2 trillion, which earns hundreds of millions of dollars for the government every year. In fact, nearly every year since its inception in 1968, the corporation has earned profits for the U.S. government. Even during this crisis, Ginnie Mae, in contrast to many other MBS entities, earned profits: $906 million in 2008, $509.6 million in 2009, and $541.5 million in 2010. And for the first three quarters of this year, the corporation has already earned approximately $650 million. Fiscal year 2011 is expected to be our best year ever; Ginnie is likely to earn a billion dollars.

The Business Model

This remarkable performance can largely be attributed to its business model. Ginnie Mae manages a carefully designed MBS program. In fact, the corporation pioneered this market, creating and guaranteeing the first mortgage-backed security in the United States in 1970. Freddie Mac followed the next year, and Fannie Mae issued its first security in 1981. Pioneering the MBS has given Ginnie Mae more than 40 years to refine and enhance its program.

The Ginnie Mae business model avoids exotic products and business lines. The corporation does not buy or sell securities or loans for investment purposes. Ginnie Mae only accepts loans insured or guaranteed by other government agencies as collateral for its securities. This ensures that it does not take on borrower-related credit risk. Ginnie Mae's risk is limited to the performance of its Issuers. Thus, the government's full faith and credit guaranty is only at risk when an Issuer in our program is unable to pay the principal and interest due to investors. When an Issuer does fail to meet its obligations, Ginnie Mae may not lose money because it assumes control of the portfolio and can either sell or manage it in-house in the most profitable manner. We choose to sell or manage the portfolio based on the best way to minimize the cost to the guaranty fund. Keep in mind, there is only a cost to the guaranty fund if the defaulted servicing portfolio has negative economic value.

As other MBS businesses struggle, Ginnie Mae stands out for its ability to effectively manage its MBS program. A conservative approach to management that rests on a solid, inherently risk-averse business model has allowed Ginnie Mae to thrive during this economic crisis. The foundation of the Ginnie Mae business model is the simple pass-through security backed by government-insured loans issued by private lenders. These private lenders play a crucial role in the MBS process: they protect Ginnie Mae and taxpayers from risk.

In the Ginnie Mae program, private lenders remain financially responsible for the securities they issue; their capital stands in front of the Ginnie Mae guaranty. Although the securities carry Ginnie Mae's name, lenders serve as the securities'-Issuers-of-record and as such are responsible for making all payments to investors. Ginnie Mae does not buy loans nor create and issue securities as is done in the GSE programs. The role of private lenders in the Ginnie Mae business model is a critical difference that distinguishes our operation from that of the GSEs.

Private lenders pay Ginnie Mae a fee to wrap the security in our guaranty. Ginnie Mae is essentially a re-insurer; the security and the payments due to investors remain the responsibility of the lender as long as there is an outstanding balance on those securities. If borrowers are delinquent in making their payments, lenders must pay the difference to investors, and lenders must continue advancing these funds until they are bankrupt or are defaulted by Ginnie Mae.

These loans are insured so when borrowers become delinquent and the foreclosure process is complete, Issuers can seek reimbursement from FHA, VA, or RD. While most of those expenses will be reimbursed by the insuring agency, rarely are all of the expenses reimbursed. In fact, our Issuers consistently report that they lose between $5,000 and $10,000 on every FHA claim and even more on VA claims. The risk of these losses means lenders must have sufficient capital to absorb them when necessary.

Our program is designed so that the capital of the lenders who issue Ginnie Mae securities is available to assume losses before Ginnie Mae or taxpayers do. Having lenders act as the Issuer of the security has the added benefit of ensuring that lenders have "skin in the game." This provides an incentive for lenders to originate well-performing loans. If loans do not perform well, the lender must pay investors on behalf of the borrower. I cannot emphasize enough how important this extra layer of capital is in mitigating the taxpayer risk exposure associated with secondary market transactions.

Under the Ginnie Mae business model the risk of paying out on the guaranty is remote. There are actually several layers of capital that must be exhausted before the guaranty is at risk of losses. The first layer of protection is the homeowner's equity, the second is the credit insurance, and the third is the capital held by the lender.

This third and final layer of protection, which I previously described as skin in game, may be the most important as it means Ginnie Mae Issuers must absorb all losses. It bears repeating that by focusing solely on guaranteeing securities payments due to investors, avoiding exotic lines of business, insulating itself from risk, and requiring skin in the game, Ginnie Mae has created an MBS program that thrives even during the most challenging economic times.

Finally, another element of the Ginnie Mae business model that has been an important part of its success is that we have only one objective: financing affordable housing. Ginnie Mae is a wholly-owned government corporation whose only mission is to serve taxpayers. We do not have that fundamental conflict between executing the nation's housing policy and earning a return for shareholders. We serve only one master: taxpayers, and as a result there is no motive to increase market share or earnings. This has allowed to us navigate the crisis in a manner that is beneficial to all.

Ginnie Mae's Priorities

In addition to maintaining a strong efficient business model during my tenure, I have focused on three things at Ginnie Mae: creating an organization that is more customer-centric, enhancing our risk management practices, and increasing our resources.

Customer-Centric

One of my first priorities when I took office at Ginnie Mae was to establish an environment that is very focused on serving our customers. At Ginnie Mae, we are working in a manner that better serves our Issuers, provides value to investors, and protects taxpayers. We are renewing our efforts to listen and develop solutions for our business partners. We are providing new disclosure information about the loans backing our MBS to spur more efficient pricing of these securities. We have also moved to reduce interest costs associated with carrying loans until they can be securitized by allowing the daily issuance of MBS. And we created an enhanced manufactured housing securitization vehicle to recognize the vital role that manufactured housing plays in affordable housing for millions of families.

Risk Management

As the market fluctuates and lenders face increasing risk, we've made several changes to our program to strengthen our risk management practices. To assure continued accountability for our efforts, Ginnie Mae has had a Chief Risk Officer (CRO) in place for more than three years. One of my primary goals has been to expand our risk analysis capability by establishing a more comprehensive Enterprise Risk Office.

Our CRO and his team monitor corporate risk and compliance with risk policies, develop and maintain corporate-wide procedures for risk management, and provide oversight of all risk management activities.

Additionally, we have implemented policies that strengthen the financial capacity of our counterparties. This includes increasing net worth requirements, and for the first time, establishing capital and liquid asset requirements for all Issuers across all of our business lines. The liquid asset requirements are especially important as they ensure our counterparties have the funds available to meet their investor payment obligations.

Specifically in our program, we increased the base net worth requirement for single-family program participants from $1 million to $2.5 million. For multifamily lenders, we increased net worth requirements from $500,000 to $1 million. And for the home equity conversion mortgage business line we increased the requirement from $1 million to $5 million. When we launched the new manufactured housing program in October 2010, we established net worth requirements of $10 million. The HMBS and Manufactured Housing programs require more capital as these products expose the organization to greater risk. Imposing these requirements reflects Ginnie Mae's commitment to prudent risk management.

Increasing Resources

Increasing resources at Ginnie Mae is another top priority. We have embarked on a multi-year hiring initiative designed to appropriately staff the organization. Although Ginnie Mae has managed the increased business volume extremely well, rising to the challenge posed by this economic crisis has been difficult given our limited staff and resources. Ginnie Mae needs additional resources to effectively manage the risks and provide customer service in the current economic environment. The President's 2012 budget addresses this need by proposing a significant increase in Ginnie Mae salaries and administrative expenses (S&E) and a fund from which all salaries and expenses would be paid. The fund would be financed with Ginnie Mae's commitment and multiclass fee income. This financing approach enables greater capacity, service, and protection to taxpayers, without requiring any taxpayer support[5]. More importantly, the proposal would allow Ginnie Mae to increase its staff level to strengthen risk management and oversight. It is critical that Ginnie Mae have the additional resources and flexibility to effectively respond to market needs and to continue responsibly bringing global capital into the American housing finance system.

[5] Ginnie Mae is a self-financing organization. All of its expenses are paid from the fees its collects on securities. However, its salaries and expenses, though funded from fees, are part of the appropriations process.

Comments on the Qualified Residential Mortgage Rule (QRM)

As President of Ginnie Mae, I have had the opportunity to evaluate the impact of regulation from the perspective of securities Issuers and investors and realize that finding the right balance between protecting investors and not unduly hampering the flow of capital is challenging. The Dodd-Frank legislation appropriately recognizes that risk retention is an important part of creating a sustainable housing finance system. It is no secret that lack of "skin in the game" led to poor underwriting decisions resulting in placing people in homes they could not afford. The impact of these decisions has rippled through our financial system, disrupting every element of the mortgage process. It has had an especially negative impact on the securities markets. Private MBS investors have left the market almost entirely and will now invest only in MBS backed by the government. This is reflected in the current private label market share of less than 10 percent.

If we are to reform our housing finance system, it is critical that we get this right. We strongly support developing a rule that brings discipline to the markets. Issuers and originators must have an incentive to make sustainable loans. Without it, we risk another crisis. The QRM rule seeks to define those mortgages that would not be subject to risk retention. It considers many factors, among them down-payment, credit history, and the borrower's capacity to repay. Our challenge is to craft a rule which balances these factors in the manner that protects borrowers and allows for a robust flow of capital. There are always trade-offs in this equation; higher down-payments protect against risk, while at times making it harder for some to purchase a home. We must weigh protecting our housing finance system against the goal of ensuring robust liquidity. It will not be an easy task, but I assure you that HUD and the regulators are committed to releasing a rule that accomplishes this goal.

Comments on Legislative Discussion Draft

I appreciate the opportunity to share comments on the initial discussion draft. The legislation includes a provision that would give the Chief Financial Officer (CFO) the ability to offer independent views on matters concerning Ginnie Mae. While we understand the committee's desire to maintain a close review of Ginnie Mae's financial condition, we respectfully believe that this provision is not necessary. We are a relatively small agency, my staff and I are directly responsive to inquiries from Congress and this committee, and HUD's Office of Inspector General provides independent oversight. To the extent that the committee believes additional oversight may be necessary, we would recommend that the focus be placed on the role of the agency's Chief Risk Officer, because the major risks to Ginnie Mae center on the capacity of its Issuers to meet their obligations to investors and deterioration in portfolio servicing values. Thus, potential problems at Ginnie Mae are likely to be identified through our risk management practices and Issuer monitoring activities long before they impact our financial condition.

I would like to call your attention to one additional issue regarding this provision. The discussion draft would substantively alter the accounting and budgetary requirements currently applicable to Ginnie Mae. The Ginnie Mae CFO currently maintains an independent financial accounting system that supports a business type budget. To support this budget, the CFO adheres to Generally Accepted Accounting Principles (GAAP) whereas many federal agencies, including HUD, use budgetary accounting. The CFO is responsible for maintaining this budget and the supporting accounting system pursuant to the Government Corporation Control Act, 31 U.S.C. § 9103.

The proposal which requires the CFO to comply with the section 902 of title 31 of the United States Code would establish new requirements for Ginnie Mae. The maintenance of the new system would require additional staff and create unnecessary costs without significant benefit since Ginnie Mae has prudently managed its programs and finances under the requirements of the Government Corporation Control Act. Therefore, we recommend citing the Government Corporation Control Act rather than the statute cited in the legislation.

Conclusion

Madam Chair and Ranking Member Gutierrez, our housing finance market remains fragile. Congressional action, Administration efforts, and government programs have stemmed the tide of economic and housing upheaval, provided needed liquidity, and helped keep the market from complete collapse. The Administration has introduced plans for housing reform to correct fundamental flaws in housing finance, create a foundation for sustainable homeownership, and bring an appropriate balance of smart government and private market participants to housing finance.

The Ginnie Mae business model successfully balances the role of the private market with that of government. During this crisis, through Ginnie Mae, 4.4 million homeowners have obtained low cost financing for mortgages, lenders have maintained access to the capital markets at a reasonable cost, and billions of dollars have been earned in profits for taxpayers. Indeed, while it is clear Ginnie Mae has been a stabilizing force in the housing market during this volatile period, the market requires meaningful reform so private investors can confidently participate in the housing market and provide a funding source for mortgages outside of the traditional government-supported institutions. Until then, Ginnie Mae will continue to provide the necessary funding to keep government-insured products available for families across the country.

Madam Chair, I hope my testimony today has contributed to a greater understanding of Ginnie Mae and the value it contributes to our housing finance system.

As someone who has worked in the capital markets for more than 30 years and who now oversees a mortgage securitization program that has served its constituents efficiently and effectively, I have become a passionate believer in Ginnie Mae's role and function. By pioneering the MBS, Ginnie Mae forever changed the way housing is financed. It is because of the Ginnie Mae MBS that an investor in Asia can make it possible for a family in Texas to own home. I am committed to strengthening this unique organization so that it continues to make a sound contribution. I welcome the opportunity to work with Congress on these efforts. Thank you for giving me the opportunity to testify today, and I look forward to answering any questions you may have.

PASSBACK
RURAL DEVELOPMENT
Statement of Tammye H. Trevino, Rural Housing Services Administrator
Before the House Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single and Multi Family Mortgage Market Hearing
September 8, 2011

Chairwoman Biggert, Ranking Member Gutierrez and Members of Subcommittee, it is my privilege to be with you today to discuss USDA's role in supporting America's continuing need for safe, affordable places to call home. For over 60 years, the Rural Housing Service, part of the Department of Agriculture's (USDA's) Rural Development Mission Area, along with the Rural Utilities Service and Rural Business – Cooperative Service, has been working to help rural America thrive by supporting the housing needs of these communities.

Rural Development is a collaborative agency. Our programs build upon one another ultimately creating efficiencies for the taxpayer and the communities we serve.

We have exceptional staff in our network of 47 state offices and 500 area offices across the rural landscape working closely with dedicated partners in the for-profit and non-profit sectors. Rural Development State Directors deliver programs for all three agencies in the Mission Area. By being located in rural communities, we are able to cultivate important relationships with lenders, realtors, community-based organizations, county housing and redevelopment authorities, and others. We are able to be more efficient with our overhead costs because we strategically centralize a significant portion of core operations, while leveraging the community knowledge of our field structure across all programs. For example, staff delivering Rural Housing Service's Community Facilities program to eligible municipalities, tribes, and non-profit organizations also work with these same partners on the Rural Utilities Service's Water & Waste Disposal program. The importance of our local staffers cannot be overemphasized; they know the needs of their neighbors and their rural communities, and provide critical support both effectively and efficiently.

Rural Development's Rural Housing Service has single-family homeownership programs, multi-family housing programs, housing loans and grants for repair and rehabilitation, and community programs.

As part of the Rural Development Mission Area, Rural Housing Service programs are integrated into a more holistic approach to rural community and economic development. As a vital part of Rural Development, the Rural Housing Service helped more than 150,000 rural American families become homeowners in FY 2010, and an additional 108,000 this fiscal year (through July 2011) ; provided safe, decent, affordable rental housing to 460,000 individuals; and provided financing to assist over 1,000 small communities develop essential community buildings and equipment. Utilizing a total budget authority of $1.03 billion, the Rural Housing Service leveraged a program level of approximately $26.3 billion in loans, loan guarantees,

grants and technical assistance in FY2010. Our budget targeted resources to programs that are most needed and most effective in rural communities.

Rural Development also assists rural communities – often led by volunteer municipal governments with little or no staff of their own – in planning their future. We assist with building basic infrastructure, from electricity to public water and sewer to broadband, that facilitate home construction. We create and sustain rural job opportunities and support entrepreneurs from the micro-enterprise level to large-scale manufacturing and biorefineries so those who live in rural communities don't have to commute to metropolitan areas in order to support their families and pay their mortgages. In the wake of natural disasters, Rural Development programs have worked in concert to build communities from the ground up. No other Department in the Federal family offers rural communities the range of financial services available from USDA Rural Development and staff nearby to provide technical assistance.

Rural Housing Service is able to offer full life-cycle residential options to rural citizens by virtue of the programs we provide through the Housing Act in combination with the programs we offer through the Consolidated Farm and Rural Development Act, or ConAct. If you were born in a rural hospital, that hospital might have been financed through Rural Housing Service's Community Facilities program, authorized in the ConAct. Your parents might have brought you home from the hospital to an affordable rental unit financed under our Multi Family Housing (MFH) Section 515 or 538 programs or to a home financed through the Single Family Housing (SFH) Section 502 program, either as a direct or guaranteed loan. Most of the home ownership loans and loan guarantees we make are to families, and giving rural children a safe and supportive environment in which to grow up is at the heart and soul of our Mission Area. As you become ready to rent or own your home, or you need to improve a home you already own, Rural Housing Service can offer direct financing under SFH Section 502 of the Housing Act to applicants at or below 80% of median income for the county – a program unique to USDA among Federal agencies involved in housing – or we can guarantee a loan for an applicant whose income is up to 115% of median income for the county. As you age and begin looking in your rural community for housing options with less maintenance than a single family home, we can offer elderly rental housing. Or, as your needs increase, the Community Facilities program steps in again to finance assisted living facilities and even nursing homes. Over the course of your lifetime, the quality of life in a rural town might be improved by a new library, schools, and community centers, again financed through the Community Facilities program.

Rural Housing Service is a big part of Rural Development's overall success in effective program operations. Delinquencies are less than two percent of our outstanding loan portfolio of over $150 billion. Despite doubling our borrower numbers over the last two years, Rural Housing Service's direct and guaranteed loan portfolios continue to perform well, thanks in large part to our state of the art call center, the Centralized Servicing Center in St. Louis, MO.

The delinquency rates in the 515 Multi-family Direct Loan, 514 Farm Labor Housing and 538 Multi-Family Guaranteed programs were 2.4%, 3.3%, and 7.1%, respectively on July 31, 2011. The July 31, 2011 delinquency and foreclosure rates for the Single Family Guaranteed Program were 10.2% and 3.2%.

The delinquency rate in the Single Family Guaranteed Program, which includes moratorium and other accounts in the workout process, was 18.7% on July 31, 2011. If we exclude moratoriums, which our studies indicate return a significant portion of delinquent accounts to the current portfolio, and also exclude foreclosures, the delinquency rate drops to 12.3%. The foreclosure rate in the Single Family Direct program was 5.0% on July 31, 2011, which is unexceptional when compared to current commercial levels, but the advantages conferred upon very low and low income families and their communities by homeownership are extraordinary. Homeowners enhance community stability, they reap the benefits of forced savings through their expanding home equity, they are partially shielded from the effects of inflation which can be financially debilitating at these income levels, and they attract private capital in the form of businesses seeking established communities in which to invest. But above all, home ownership provides one of the few opportunities for meaningful wealth creation, which too often proves elusive for low income Americans. Even if housing prices only keep pace with inflation, the leveraging that occurs through a mortgage loan, coupled with the long homeownership terms that are typical in the direct and guaranteed programs, often provides a critical foundation for financial independence that can support families in present and future generations, that can fortify communities, and ultimately return tax dollars to state coffers that might otherwise be depleted.

Through the Single-Family Housing programs, opportunities are provided for rural Americans with very low to moderate incomes to purchase homes. The Single Family Housing programs have assisted 92,786 families during FY 2011 to purchase or refinance a home thereby strengthening communities and neighborhoods and helping families build equity for their future. In FY 2010, the Single Family Housing programs assisted 146,890 families purchase or refinance a home, helping boost rural economies and creating thousands of new jobs in rural communities.

For FY 2011 and FY 2012, the SFH Guaranteed program has a negative subsidy rate because of a low and stable default rate coupled with increased program fees. The 2012 fee structure will be a two (2) percent up-front fee and an annual fee of 0.3 percent. The $24 billion guaranteed loan level allows USDA's Rural Housing Service to provide more assistance for single family housing in rural areas. Currently, approximately 2,000 lenders participate in the program.

The Multi-Family Housing program also carries out Rural Development's commitment to provide affordable housing options to the poorest citizens in rural America. Our existing portfolio provides safe, sanitary, and affordable residences for 460,000 tenant households.

USDA provides financing for nearly 16,000 multi-family properties in rural America, which provide housing for over 600,000 tenants, most of whom are very-low income residents in need of affordable housing. Unlike our public housing authority partners, RHS field structure is able to serve families in remote rural areas where public housing is limited. In addition, by structure and design, Rural Housing Service transactions are able to attract third party financial resources, such as Low Income Housing Tax Credits, that are not directly available to public housing authorities. We anticipate renewing 204,503 rental assistance contracts for the benefit of tenants considered low and very low income and severely rent over-burdened.

In FY 2010, Multi Family Housing program investment was used to renovate or build 214 multi-family housing projects, containing more than 8400 units, through the 515 Direct, Farm Labor Housing, and 538 Guaranteed Rural Rental Housing programs. This budget authority represented a $259 million investment by USDA, and was used to attract an additional $690 million in third-party investments for rental housing in rural America.

This year, USDA will provide approximately 2,000 grants to very-low income, elderly, rural homeowners in order to make essential repairs to their homes to make them safe and to remove health hazards through the Single Family Housing Repair grant program.

RHS is constantly looking for ways to streamline and improve its program delivery. The Agency's housing and community facilities programs have a variety of partnerships with Interior, HUD, Treasury, FDIC, FCC, HHS, and other federal partners to improve efficiency and maximize service to rural Americans. For example, RHS has been working with HUD, Treasury, OMB and other Federal partners in an effort to better coordinate Federal rental policy and identify administrative changes that could increase overall programmatic efficiency and further enhance the ability of communities to create and preserve affordable housing. Pilot implementations are being pursued in several states to test some of these administrative alignment activities on a small scale before implementing them at the national level. RHS has taken the lead on two of these very important pilot projects: physical inspections and subsidy layering review.

While we appreciate Congress' intent to identify duplication of services across the Federal government, we do not support the draft proposal in its current form. While RHS and HUD share an important commitment to meet the housing needs of rural America; we believe that the mission and delivery of programs in RHS and HUD are different and distinctive. Rural Housing, through Rural Development has the flexibility to respond to changing needs across the rural landscape and lead other public sector and private sector for-profit and non-profit partners to invest strategically in rural people and places, particularly those who are traditionally under-served by conventional financial models. With our long record of success at attracting private capital to rural areas, primarily through loan guarantees and leveraged grants; providing public capital for economic and community development where the private sector is unable to step in; and building capacity in rural communities through technical assistance, Rural Development enables significant improvement in job opportunities and quality of life for millions of rural Americans. The synergistic structure within Rural Housing Service through Rural Development enables close coordination of programs across all mission areas. This is a critical asset in rural America that is not duplicated elsewhere in the Federal Government.

A robust housing sector is critical to growing and sustaining the rural economy, and housing programs are an essential component of rural community development that serve as a catalyst for rural jobs. Rural communities have a unique set of challenges, quite different from those in urban areas, and it is imperative that we not lose focus on the specific needs and challenges in rural America. RD is well suited to address those challenges. With RD's network of Agencies and programs, we provide services and opportunities specifically targeted to improving the quality of life and promoting economic development in rural America. As policy makers look to

the future of the Federal role in housing, it is important that the discussion addresses needs that are inherently rural.

Mr. Chairman, thank you for the opportunity to be here today. I look forward to addressing any questions you and other members of the Subcommittee might have.

Statement of Community Associations Institute

to

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

"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets, Part 2"

September 8, 2011

By:
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Dear Chairman Biggert and Esteemed Members of the Subcommittee:

On behalf of Community Associations Institute (CAI)[1], we submit these comments for the record as part of the hearing on Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets. CAI would like to make the subcommittee members aware of growing concerns among our members regarding the Federal Housing Administration's (FHA) stewardship of the Condominium Insurance Program. For the past two years, FHA has mandated standards for this program without public notice or input. This has resulted in the adoption of guidelines which are excluding qualified buyers from access to FHA financing and needlessly excluding entire condominium associations from access to FHA and non-FHA mortgages. We bring these issues to your attention and encourage you to take appropriate action, including directing the agency to revisit its guidance in light of the issues we are raising.

While FHA continues to play a critical role in the recovery process, the methods by which FHA has chosen to develop and implement guidance for the condominium program continues to create unnecessary obstacles for qualified condominium buyers. FHA has developed a set of requirements for the condominium insurance program without prior notice or input by key stakeholders. This has resulted in underwriting criteria for condominium associations that do not comport with common association business operations, state law or common sense. This approach also conflicts with the guidance provided by HUD general counsel to FHA. In a memorandum to FHA, counsel noted that a more public approach to policy making benefits both the consumer and the agency. Specifically, former HUD General Counsel Diaz wrote:

> *"... Revised guidelines for legal documentation, while not rising to the level of a substantive rule that must be published in the Federal Register ... Housing should consider the advisability of using a Federal Register notice that solicits public comment before a final policy on condominium and PUD legal documents is adopted. As in the present situation, whenever an agency is considering a course of action or policy that involves divergent interests and classes of persons or when the issues are complex, interrelated, and represent a number of concessions and compromises, an administrative record can be very useful in sorting out the equities and buffering the agency's eventual decisions against legal and political challenge."*[2]

CAI has previously voiced to FHA staff its concerns with the individual association underwriting criteria. While FHA has attempted to provide greater flexibility on

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[1] CAI is a national membership organization with more than 30,000 members and 59 chapters representing the interests of residents, managers and businesses engaged in community association housing in the United States. Community associations, which consist of condominium, homeowners associations, planned communities and cooperatives account for over one in five homes in the United States and account for close to $80 billion in annual economic activity.

[2] HUD OGC Legal Opinion CIS-0091, p. 9-10 (emphasis added).

delinquencies, rental restrictions and affordable housing, the lack of stakeholder input has resulted in guidance that creates new problems for qualified condominium associations. Had FHA followed a more transparent process, it would have allowed such matters to be resolved prior to issuance of the mortgagee letter, allowing for more effective implementation.

FHA currently accounts for up to 30 percent of all condominium mortgages and, in some cases, lenders are underwriting to FHA criteria for non-FHA backed loans. CAI is not advocating for a full notice and comment regulatory process; however, as noted in the OGC memorandum, notice of the draft guidance and a period of public input would not only benefit consumers, but would also protect the agency from political and legal challenges. CAI members are disappointed that FHA continues to produce sweeping changes with no stakeholder input. As a result, the new guidance contains many provisions which will further inhibit the participation of qualified condominium associations and buyers in the FHA mortgage insurance program.

Beyond our ongoing concerns with the process of developing the new mortgage criteria, CAI has flagged areas of the guidelines that have been the source of questions, concern or confusion by our members. We hope that by bringing these issues to the subcommittee's attention, it will encourage members to direct FHA to clarify the intent of the new guidance to ensure condominium boards and management companies can work with FHA to qualify their communities for the mortgage insurance program.

Specifically, these issues include:

1) A requirement that the person certifying the association approval with FHA, under federal criminal penalty, has no knowledge of circumstances that may cause a borrower to become delinquent in their mortgage at an unspecified future date.
2) Continued reliance on a 15 percent of units, 30-day delinquency threshold for condominium assessments, which does not comport with association practices and conflicts with existing state laws.
3) The imposition, without notice or comment, of a costly mandate that condominium management companies obtain fidelity bonding even if covered by an association-obtained policy as mandated by state law.
4) A prohibition against any condominium association that has deed restrictions that impose a contractual obligation on a buyer, without an apparent understanding that <u>all</u> deed restrictions impose a contractual obligation on a buyer and are the legal basis for a condominium association.
5) The arbitrary imposition of criteria, such as disqualification from the FHA program for associations with loans or special assessments, which are not addressed by the FHA guidance.

CAI does not disagree with FHA that substantive underwriting criteria focused on assessments, delinquencies and even fidelity insurance are a sound basis for establishing underwriting guidelines. However, FHA's continued practice of developing

standards without transparency or public input has and continues to result in the establishment of standards that bear no relation to the operation of the market or state law and have created problems that could have been resolved with minimal due diligence by FHA and public input. When confronted with this, FHA has expressed a preference to continue to issue guidance and address any substantive issues once that guidance has been applied to the market. This has caused widespread confusion and inconsistent application of FHA's criteria. As a result, a survey of CAI members found that only half of condominium associations would be able to meet the FHA criteria. Additionally, more than 45 percent of condominium associations nationally reported that the lack of FHA financing has prevented owners from selling their units to qualified buyers. Even FHA reports that of the approximately 12,000 condominium associations that are eligible for recertification under the new guidelines, only about 1,000 have completed the process. It is clear from this data that FHA's process and subsequent guidance are having a negative impact on the housing market.

A more detailed discussion on each of these points can be found in the attached CAI letter to Acting Commissioner Galante.

July 25, 2011

Ms. Carol Galante, Commissioner
Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, S.W.
Washington, DC 20410

RE: CAI Comments and Recommendations Based on HUD Mortgagee Letter 2011-22: Condominium Approval Process

Dear Ms. Galante :

On behalf of Community Associations Institute (CAI), representing more than 30,000 individual members, 60 local chapters and the interests of the 1 in 5 homeowners living in community associations, please find below the comments and concerns expressed to us by our members relating to the HUD Mortgagee Letter 2011-22 (ML 2011-22 or the Guide) addressing the Condominium Approval Process. Developed without stakeholder input, the new mortgagee letter introduces new and serious challenges which will exclude financially sound condominium associations from the FHA program. This letter highlights our concerns on both the process by which the ML 2011-22 was developed and the requirements it imposes on the market.

CAI acknowledges the critical role FHA has played in the condominium marketplace since the advent of the housing crisis. Since 2008, FHA's share of condominium mortgages has expanded from single digits to more than one-third of all condominium mortgages. Without FHA financing to fill the gaps left in the market, the condominium market would be in far worse condition. However, the housing crisis is far from resolved and provisions found in ML 2011-22 will, in our opinion, further hinder the recovery by adding more uncertainty and confusion to the FHA approval process.

Concerns on the Development Process for Criteria Found in ML-2011-22

While FHA continues to play a critical role in the recovery process, the methods by which FHA has chosen to develop and implement guidance for the condominium program continues to create unnecessary obstacles for qualified condominium buyers. As it did with Mortgagee Letters 2009-46A and 2009-46B, FHA has developed a set of requirements for the condominium insurance program without prior notice or input

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by key stakeholders. As noted by CAI in previous communications, this approach conflicts with the guidance provided by HUD general counsel[1]. In that memorandum, counsel noted that a more public approach to policy making benefits both the consumer and the agency. Specifically, former HUD General Counsel Diaz wrote:

> *Federal Register Notice. Revised guidelines for legal documentation, while not rising to the level of a substantive rule that must be published in the Federal Register, still would affect the interests of many groups (attorneys, homeowners, planners, developers) who would not receive direct notice of changes through regular handbook distribution. Publication of revised guidelines in a policy notice in the Federal Register should result in a more widespread and rapid dissemination of revised FHA policy. A single one-time notice could be used, but Housing should consider the advisability of using a Federal Register notice that solicits public comment before a final policy on condominium and PUD legal documents is adopted. As in the present situation, whenever an agency is considering a course of action or policy that involves divergent interests and classes of persons or when the issues are complex, interrelated, and represent a numbers [sic] of concessions and compromises, an administrative record can be very useful in sorting out the equities and buffering the agency's eventual decisions against legal and political challenge.*

CAI has previously voiced its concerns with the individual association underwriting criteria. It appears FHA has attempted to address some of these concerns in the release of ML 2011-22. Specifically, FHA has attempted to provide greater flexibility on delinquencies, rental restrictions and affordable housing. However, as the new guidance was developed without stakeholder input, the welcome attempt to address industry concerns has again resulted in guidance that creates new problems for qualified condominium associations. Had FHA followed a more transparent process, it would have allowed such matters to be resolved prior to issuance of the mortgagee letter, allowing for more effective implementation.

Once again, the implementation of sweeping changes by FHA through administrative order means that condominium associations are forced to scramble to comply with new program rules without prior notice. That this continues to be the standard operating procedure of FHA is unsettling and also needlessly inhibiting a full recovery in the condominium market. CAI is not advocating for a full notice and comment regulatory process; rather, as noted in the Office of General Counsel's memorandum, notice of the draft guidance and a period of public input would not only benefit consumers, but would protect the agency from political and legal challenges. CAI members are encouraged by the attempt of FHA to address shortcomings found in Mortgagee Letters 2009-46A & B; however, we are disappointed that FHA has chosen yet again to produce sweeping changes with no stakeholder input. As a result, the new guidance contains many provisions which will further inhibit the participation of qualified condominium associations in the FHA mortgage insurance program.

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[1] HUD OGC Legal Opinion CIS-0091, p. 9-10 (emphasis added).

Substantive Concerns with FHA Program Criteria

Beyond our ongoing concerns with the process of developing the new mortgage criteria, CAI has flagged areas of the guidelines that have been the source of questions, concern or confusion by our members. We hope that in identifying these issues, it will allow FHA to clarify the intent of the new guidance to ensure condominium boards and management companies can work with FHA to qualify their communities for the mortgage insurance program.

Project Certification Requirement: Chapter 2 project eligibility requirements will mandate that the person submitting a project for approval attest, under criminal penalty, to three FHA imposed requirements. These requirements include that the condominium project complies with all state and local laws, the information contained in the submittal is true and correct, and requirement #3 which reads:

> *The submitter has no knowledge of circumstances or conditions that might have an adverse effect on the project or cause a mortgage secured by a unit in the project to become delinquent (including, but not limited to: defects in construction; substantial disputes or dissatisfaction among the unit owners about the operation of the project of the owner's association; and disputes concerning unit owner's rights, privileges and obligations). The submitter understands and agrees that the submitter is under a continuing obligation to inform HUD if any material information compiled for the review and acceptance of this project is no longer true and correct.*

CAI Comments: CAI believes it is appropriate that a person or entity submitting a project approval attest to the association's compliance with current law and the truthfulness of the information submitted. However, this requirement also entails that the submitter agree to provide HUD with information on an ongoing basis that does not comport with the transactional nature of FHA approval and the varying entities who may submit a project on an association's behalf. This attestation also requires the submitter to make, under criminal penalty, guarantees as to the ability of a borrower to meet *future* mortgage obligations. As such, the requirements implemented in section three are too vague, too broad and impose punishments so severe that CAI believes that no association, attorney or project approval specialist will advise associations to sign such a statement. Our concerns on this provision center on the issue of future condition of the borrower and the ongoing reporting requirement imposed by it.

Association Boards Cannot Attest to Future Conditions: First, requirement #3 of the project certification imposes a condition that the submitter attests to current and future conditions of the property that may affect the borrower's ability to be current in their mortgage. Specifically, defects in construction; substantial disputes or dissatisfaction among the unit owners about the operation of the project of the owner's association; and disputes concerning unit owner's rights, privileges and obligations. This imposes a standard that is too vague, and too broad for any reasonable form of compliance. As drafted, this section not only requires the submitter to attest that they have no current knowledge of such conditions, but also requires them to attest that such current conditions will not have a future impact on the person holding an FHA mortgage. This is an impossible standard to meet.

Condominium associations are governed by residents elected by unit owners in periodic elections. CAI survey data demonstrates that condominium owners and residents of community associations have high satisfaction rates with the leadership provided by their elected boards, with 8 in 10 residents expressing approval of how their community is governed and more than 9 in 10 believing the board acts in the owners' best interests.[2] However, in any self-governed process, disputes are not uncommon. In fact, in any democratic process, debate and disagreement on policy are the lifeblood of a vibrant community in which members engage in defining their living arrangements from diverse viewpoints. As such disputes are not uncommon in a condominium association and are as much an indicia of a healthy community as a sign of distress. A vast majority of condominium association disputes are resolved without litigation; however, there exists no clear process by which a board member or project submitter can reasonably certify that such disputes will not have a future effect on a borrower.

Ongoing Reporting Requirement Impractical for Submitter and HUD: Second, project certifications can be made by members of the condominium association board, attorneys, professional community association managers and businesses specializing in FHA project approvals. The standards imposed by FHA do not address that, in most cases, the project approval process is transactional in nature and does not lend itself to ongoing reporting by a homeowner volunteer or by a business or agent. An association may engage a management company, attorney or project approval company for project approvals on a transactional basis. The ongoing reporting requirement will radically change that relationship and require that any firm engaged in project approvals be hired not only for the approval itself, but for a 2-year period to meet monitoring requirements. This will needlessly increase the cost of obtaining FHA project approvals, which already can run as much as $6,000 per association. Additionally, considering that FHA has to engage a contractor to assist in processing the volume of applications it received, and the volume of the applications remains low compared to the total number of condominium associations, it is unlikely that FHA or HUD has the resources to process such materials.

CAI Recommendations: CAI believes that, in its current form, section three of project certifications is unworkable and will have a negative impact on the market by discouraging qualified associations from submitting project approvals. This requirement will restrict credit to otherwise qualified borrowers, will result in lost sales and will have a negative impact on the market and on FHA's current condominium portfolio. CAI recommends this section be modified so the submitter provides FHA with any current knowledge on litigation and to attest to such factors that may impact the borrower at the time the package is sent to FHA. Such a section should read:

> *#3 At time of submission, submitter has no knowledge of any conditions that might have an adverse impact on the project or knows of any existing litigation filed against the association. Submitter has an obligation to notify FHA, after project submission but prior to project approval, if such conditions change.*

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[2] *What do Americans Say about their Community Associations?*, National research by Zogby International, 2009, Community Associations Institute.

Delinquency Criteria: Section 2.1.5 of ML 2011-22 revises allowable delinquency criteria for condominium associations participating in the FHA program. Specifically, FHA has retained the 30-day, 15-percent-of-units delinquency standard; has expanded delinquencies to now include bank-owned (REO) properties; and allows for limited expectations beyond the 15-percent threshold if certain conditions are met.

CAI Comments: The provisions under section 2.1.5 provide additional flexibility that follows some of the recommendations made by CAI to FHA. However, the inclusion of REO property and the continued use of the 30-day delinquency measure will offset any benefits of the proposed flexibility and will likely lead to fewer projects qualifying for FHA condominium mortgage insurance. Our concerns are focused on three areas: delinquency period, burden of determining ownership of REO properties and required disclosures to qualify for exemptions.

30-Day Requirement Unreasonable: First, the requirement that no more than 15 percent of the total units can be more than 30 days in arrears on association assessments is an arbitrary number and does not adequately measure the financial health of the community. Increasingly, condominium associations are budgeting for bad debt, so even though 15 percent of the units may be delinquent, the association may still be able to meet its budget obligations to maintain the association's common property. Therefore, if an association maintains an allowance for delinquent assessments and the delinquencies do not exceed any budgeted bad-debt allowance, the delinquencies should have no impact on funding continued operations and routine maintenance.

Additionally, a 30-day test for delinquencies fails to take into account time periods required under various state laws with respect to any notice and mandatory payment plans. The association must comply with these time periods as a precondition to its collection efforts.[3] In many cases, the association begins the process of tracking and seeking collection at or beyond the 30-day delinquency date, therefore, making a delinquency determination at such an early date difficult. Thus, many associations will be unable to meet the 30-day delinquency window because of requirements of state law, not because of the financial condition of their community.

CAI Recommendation: Community associations should have no more than 15 percent of the total units more than 90 days past due. This change would be consistent with existing association practices and emerging state law requirements, and would be in line with the larger financial picture FHA will allow under ML 2011-22.

Assessment Burden of Bank Owned Properties: CAI agrees with FHA that the failure of REO properties to pay assessments can have a negative impact on the financial health of the condominium association. It is critical that such assessments be paid to protect current condominium owners as well as the value of loans in FHA's existing portfolio. However, the revised guidance places the burden of determining the ownership of such property and collection of such fees on the volunteer boards of condominium associations, who are in the least advantageous position to determine ownership and collection of past due assessments.

It is not always clear to a condominium association who is the owner of a foreclosed property. This problem is so pervasive as to be the subject of numerous exposés in the press, including a

[3] General Assembly of North Carolina Session 2011, Session Law 2011-362.

recent segment on 60 Minutes.[4] CAI members report that, in many cases, lenders delay filing the paperwork or recording deeds on foreclosed property specifically to avoid paying assessments. This problem was pervasive enough in California that CAI worked with the state legislature to pass a law[5] requiring the party taking title in foreclosure to record and notify the association within a specific time period for the purposes of collecting assessments. Other states have worked to provide for a priority assessment lien. Such liens give the association up to 6 months of past due assessments, prior to satisfying the underlying mortgage, in the event of foreclosure. Despite these efforts, a survey of CAI members indicates that nearly 8 out of 10 REO properties do not pay required condominium assessments. That same survey also indicates that payment of assessments is a legal obligation of owners of property in a community association. Those who are not paying assessments are breaching their legal obligations to the association and undermining the value and marketability of all properties in the development. The FHA Condominium Mortgage Insurance Program provides a tangible benefit to lenders by insuring the mortgage against default by an FHA-qualified borrower. In exchange for receiving this guarantee, it would make sense that FHA would want to ensure that lenders participating in the program are not subsequently undermining the soundness of FHA-backed mortgages by not paying assessments on properties they own. This approach would work to resolve a problem that has confounded state legislators and volunteer condominium board members for some time. Such an approach would also ensure that borrowers are not undermining the FHA programs they are relying on for their mortgage products.

CAI Recommendation: FHA should not include bank-owned properties in the determination of association assessments. Rather, FHA should require that approved mortgagees disclose to FHA any condominium properties currently owned and provide FHA with proof that assessments are being paid on said units. This action alone will significantly reduce delinquencies caused by FHA-approved mortgagees that have a material impact on the performance of FHA's condominium-related book of business. Additionally, CAI has received multiple reports from condominium associations that HUD itself routinely fails to pay assessments on HUD-owned properties. CAI strongly urges FHA to catalog properties for which a claim has been paid to ensure the Agency is actually working to resolve the problem of REO-related delinquencies rather than exacerbating the problem.

Requests for Exceptions: ML 2011-22 has introduced some flexibility in regard to assessment delinquencies; some of these recommendations mirror suggestions made by CAI in communications with FHA in December 2009. The added flexibility takes into account that the current measure of delinquencies may be excluding otherwise qualified associations by looking at their finances at a specific point in time rather than looking at the associations' broader financial picture. CAI applauds FHA for taking these steps, and we hope these additional comments can assist in ensuring that the flexibility can be conducted in a manner that comports with condominium association operations.

Specifically, Section 2.1.5 allows for up to 20 percent of units to be no more than 30 days in arrears, provided the following six conditions are met:

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[4] *The Next Housing Shock*, 60 Minutes, April 1, 2011.
[5] Senate Bill 1511 (2008) enrolled as California Civil Code Section 2924b.

1. The homeowners' association (HOA) provides a report for the past 6 months that reflects the history of unpaid assessments.
2. The HOA current reserve fund balance and current operating results (documented HOA Balance Sheet and Income/Expense financial statements dated less than 90 days at the time of submission) evidences excess available funds in the amount of the outstanding arrearage.
3. A review of the HOA financial statements and verification of the reserve account balance reveals that the HOA has sufficiently accounted for bad debt and arrearages.
4. A current reserve study that is no greater than 24 months old supports the sufficiency of the current HOA assessments to meet the project component replacement needs.
5. The HOA provides evidence of actions to collect the unpaid arrearages, including legal action, execution of payment plans, or other similar efforts.
6. The exception terminates with the expiration of the current condominium project approval.

CAI believes that this approach would provide FHA with a more detailed and accurate picture of the financial health of the association over a period of time rather than at the point of application and that the required disclosures, with the exceptions discussed below, will provide a more fair opportunity for associations who do not meet the arbitrary 15-percent, 30-day-delinquency window or those who cannot meet it due to conflicting state laws. CAI's concerns with the new delinquency guidance follows:

The second provision of the required reports for the assessment exception reads:

> *The HOA current reserve fund balance and current operating results (documented HOA Balance Sheet and Income/Expense financial statements dated less than 90 days at the time of submission) evidences excess available funds in the amount of the outstanding arrearage.*

CAI believes the intent of this statement is to allow FHA to gauge the impact of delinquencies on operations *and* reserve accounts, two critical measures of an association's current and future fiscal health. As FHA is aware, the operating account and the reserve account each have distinct functions. As drafted, CAI members have expressed concern that FHA is conflating these two accounts in a manner that may cause unit owners to believe that such funds can be freely transferred from reserves to operations. While such transfers are possible, such "borrowing" from reserves has tax consequences and may trigger reporting or notice requirements by the board. This may also lead to special assessments or other problems in out-years if reserve funds can be transferred to operations. As each account has a dedicated and critical function in assuring an association's fiscal health, examination of these accounts should treat them according to their function.

CAI Recommendation: CAI recommends that this provision for exception to the 15-percent, 30-day-delinquency requirement be applied in a manner that examines the funding levels in the operating account and reserve account separately to ensure adequate funding is available for current operations as well as future obligations.

Fidelity Bonding of Management Companies: Section 2.1.9 of the Guide requires fidelity coverage for the theft of a community association's funds. That Section imposes two different

requirements: coverage for a theft committed by a board member of an association must be covered by fidelity insurance, and coverage for a theft committed by a management company hired by an association must be covered by a fidelity bond. Fidelity insurance and a fidelity bond are not synonymous.

A fidelity bond is a 3-party contract in which a bonding company guarantees to reimburse a party for any losses it suffers caused by the dishonest acts of another party. Each person that is bonded is named and has been scrutinized by a bond company for "character, capacity and credit." Unlike a fidelity bond, fidelity insurance is a policy of insurance. It is a 2-party contract just like any other policy of insurance involving the insurer and the insured. As the Guide shows, fidelity insurance is known as employee dishonesty insurance or crime insurance.

The need to protect an association from an unreimbursed loss of funds resulting from a dishonest act of a management company has been addressed by the community association industry. Fidelity bonds are not used in the community association industry to protect an association's funds. The protection is afforded by an association's employee dishonesty policy that extends coverage to a management company. The primary reason fidelity bonds are not used in the community association industry is the impracticality of naming and the cost of investigating each person within a management company that has access to association funds. Since bonds specifically identify the persons that are bonded, bonds do not automatically cover new employees.

Even if fidelity bonds were available for management companies, the specific coverage required by the Guide will be practically unattainable. The specific coverage issues created by the Guide are:

- The minimum amount of coverage required by the Guide fails to recognize the constant change in the amount of funds under the control of a management company. For example, an association that imposes assessments on an annual basis will have an ever-declining balance as a year progresses. Bonds are not variable; the premium, if a bond could be obtained, is based on the maximum potential loss. Such a premium would be based on an amount that will exist for less than 30 days.
- The Guide requires a management company to obtain a separate bond, in the minimum amount, for each of its association clients. A management company will not be able to afford the premiums. Bonds are not like an insurance policy that can name additional insureds on a single policy, thereby, reducing costs. Few associations will be able to afford the pass through of the cost of a bond.
- The Guide also requires a management company's bond to cover the total funds in the custody of the owner's association. That requires a management company's bond to cover funds that are not in the management company's custody or control. Bonds require the bonded person(s) to have custody and control of the covered money and securities.

Most associations do not allow a management company to have access to its reserve funds. Access is restricted to members of the association board. The Guide requires all management company bonds to be in a sum that includes reserve funds, regardless of whether the company has access to those funds.

The only way to achieve FHA's goal of avoiding an unreimbursed loss caused by a management agent's theft of association funds is to add the management company as an insured under the association's employee dishonesty policy. A management company can be included in the definition of an employee, just as members of a board of directors are considered employees for that coverage. Alternatively, a management company can be covered by a designated agent endorsement, ISO Form.

Insuring an association's funds from theft by a management company with an employee dishonesty insurance policy meets the entire fidelity requirements of the Guide and has the following advantages for an association:

- The Guide requires an association to obtain and maintain the insurance so all claims are controlled by an association as the first party insured. An association, as the insured, files a claim with the insurer and covered claims are paid directly to the association. (The bond requirement obligates an association to require the management company obtain the bond.)
- The minimum coverage's required by the Guide are insured by a single policy that covers acts of theft committed by both members of a board and management agents. The issue of custody or control created by the bond requirement is eliminated.
- Since the minimum coverage required by the Guide for board members and a management company is the same, there is little or no added cost to extend coverage to the dishonest acts of a management company. The amount of coverage, not the number of persons with access to an association's funds, establishes the premium.
- Reserve funds are covered, regardless of whether access is restricted to board members or if access is given to a management company.

The Guide also requires a management company to carry a policy, even if it would be covered by appropriate state law. In at least three states, Florida,[6] Virginia[7] and Maryland,[8] an association may purchase fidelity insurance to cover acts by agents of the association. Under the provisions found in Section 2.1.9, a management company would be required to obtain duplicate coverage. This imposes a costly and unnecessary burden on businesses and homeowners.

FHA's requirements also stand in stark contrast to the treatment of fidelity insurance issued by Freddie Mac. While Freddie Mac requires fidelity insurance as a condition for mortgage issuance in a condominium, its guidance[9] is a model of an appropriate and flexible approach more appropriate to the market place. It simply requires:

> *The condominium owners association must carry fidelity insurance covering losses resulting from dishonest or fraudulent acts committed by the association's directors, managers, trustees, employees or volunteers.*

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[6] Florida Statute 718.111(11)(h).

[7] Virginia Code Section 55-79.81(b).

[8] Ann. Code of Maryland, Real Property Article, Title 11, Section 11-1141.1 Fidelity Insurance (a)(2)(ii).

[9] See Appendix A: Freddie Mac Condominium Insurance Requirements.

CAI Recommendation: It is CAI's recommendation that Section 2.1.9 of the Guide be amended by deleting the second section that addresses a management company and amending the first section in the following manner:

> *For all new and established projects with more than 20 units or for any project that engages the services of a management company, the condominium association is required to obtain and maintain employee dishonesty or crime policy insurance that meets these requirements:*
>
> - *The condominium association must maintain this insurance for all officers, directors, employees of the association, and all other persons handling or responsible for funds administered by the association;*
> - *If the condominium association engages a management company, it must also maintain this insurance coverage for the management company and its officers, employees and agents handling or responsible for funds of or administered on behalf of the condominium association; and*
> - *The coverage must be in an amount not less than the estimated maximum funds, including reserve funds, in the custody of the condominium association or a management company, but in no event be less than a sum equal to 3 months aggregate assessments on all units plus reserve funds unless state law mandates a maximum dollar amount of required coverage.*

CAI believes that this approach would provide the coverage intended by FHA against theft of funds, but in a manner that is commercially practicable, reflects state insurance requirements and would mirror existing guidance imposed by Freddie Mac.

Deed Restrictions: Section 1.8.8 reiterates existing regulatory provisions under 24 CFR 203.41 that require FHA-insured property to be free of restrictions that prevent the borrower from freely transferring their property. It is noted in the Guide that deed restrictions which would "be the basis of contractual liability of the borrower" shall be excluded from FHA approvals.

CAI Comments: Section 1.8.8 references existing regulatory requirements on issues of free transferability. CAI reads this section as FHA incorporating these provisions by reference. However, FHA misstates existing regulations on deed restrictions and does so in a manner which would exclude all condominium associations from FHA's condominium insurance program. Specifically, the second bullet point in this section notes that deed restrictions which would "be the basis of contractual liability of the borrower" as grounds for rejection.

As FHA should be aware, this is a material misstatement of the provision found in 24 CFR 203.41(3)(ii) which actually reads:

> *(ii) Be the basis of contractual liability of the mortgagor for breach of an agreement not to convey, including rights of first refusal, pre-emptive rights or options related to mortgagor efforts to convey;*

The clear intent of the regulations referenced by FHA is to exclude deed provisions that create a right of first refusal. As drafted by FHA, the guidance excludes any condominium association where the deed restrictions are the basis of contractual liability for the borrower. As all deed

restrictions impose contractual liability on a purchaser and in fact serve as the basis upon which the entire legal structure of condominiums is based, FHA's current language will serve to exclude all condominium projects from the FHA program on this basis. We do not believe that this outcome was the intent of this section, but rather to reiterate the regulatory restriction on rights of first refusal found in 24 CFR 203.41 (3)(ii).

CAI Recommendation: FHA should update the language in Section 1.8.8 to reflect the actual regulatory restrictions imposed under 24 CFR 203.41(3)(ii), as noted in our comments, that deed restrictions which impose a contractual right of first refusal are disallowed, not that any deed restriction which imposes a contractual obligation is disallowed.

Commercial Space: Mixed-use developments are becoming increasingly prevalent across the country. HUD has recognized this in the Sustainable Housing and Communities Program, which is focused on connecting jobs to housing to reduce transportation costs for families, improve housing affordability, save energy, and increase access to housing and employment opportunities.

CAI commends FHA for allowing some flexibility in this requirement by allowing up to 35 percent of commercial space in some circumstances. This will provide additional flexibility and move the requirement to be more in line with HUD's goals of sustainable development. We encourage FHA to continue to review this requirement for greater flexibility.

CAI Recommendation: Condominium projects with up to 45 percent of commercial space should be eligible for FHA approval. The condominium developer or association should be able to provide reasonable evidence that common areas can be properly maintained and required reserves fully funded with assessments on residential and commercial units.

Special Assessments: Section 2.1.7 of the Guide requires the submitter of the project approval to provide information on special assessments. Where a special assessment has been approved and is pending, FHA will require the submitter to verify:

- What is the purpose of the assessment;
- What is the affect on marketability of any of the units;
- Have other special assessments been required;
- When is the assessment to be paid (i.e., required to be pre-paid or is it payable over a specified period of time);
- How will the assessment impact the overall financial stability of the project; and
- What is the impact the assessment will have on the future value and marketability of the property?

Condominium associations raise revenue through limited means: periodic common expense assessments; user and other fees; and special assessments. Members, acting through their elected boards and the association membership at large, approve funding mechanisms and allocate expenses according to the preferences of the unit owners. Special assessments are typically used when an association faces a large, non-budgeted expense and the owners vote to assess an additional amount to cover these costs.

CAI's concerns with this Section mirror those discussed in the project certification section. Specifically, with FHA's requirement that an association certify to FHA the future impact a special assessment will have on the value and marketability of the property. This is not an objective criterion, and thus cannot be provided by the submitter. Also, CAI questions the appropriateness and even legality of having the association conduct an appraisal of a project they are undertaking. As all data submitted for project approvals is subject to the project certification requirement, CAI believes that FHA should focus any certifications or attestations on current and verifiable data rather than on speculative assumptions on the future.

CAI Recommendation: FHA should eliminate or clarify the requirement that associations provide information on the future impact of any special assessment; as such a standard is conjecture. FHA may wish to seek information on the goal of the special assessment as it relates to the association and property values.

Leasing Restrictions: Section 1.8.9 addresses issues of leasing restrictions and incorporates the provisions found in the waiver to ML 2009-46B issued by FHA in March 2011. Allowing rental restrictions will assist condominium associations in meeting the owner occupancy requirements set by FHA. CAI also notes that the guidance finds that such restrictions improve "marketability of the whole community." However, the rental restriction language includes a provision that undermines the goals of FHA on financial soundness and the safety of the community. That provision reads:

> *The condominium association may not require that a prospective tenant be approved by the condominium association and/or its agent(s), including but not limited to meeting creditworthiness standards.*

This provision causes concerns for CAI. The condominium association or the unit owner has an interest in assuring that any tenant be financially qualified to lease a unit. Current federal Fair Housing Laws provide additional protection against any unfair or discriminatory restrictions. The board of a condominium association is charged with ensuring members' satisfaction with their community and its financial well being. As such, unit owners and their boards are in the best position to determine what the needs of the community are, provided they comply with existing federal law. Failure of a tenant to pay rent can impact the unit owner and lead to delinquencies on assessments or mortgage payments. As such, allowing the unit owner or association to check the creditworthiness of a prospective tenant would work to further the goals of FHA in assuring the financial soundness of the community.

CAI Recommendation: CAI recommends that FHA allow for a limited right of the owner or the association to impose rental restriction standards on creditworthiness.

Conclusion: CAI commends FHA for working to address some of the concerns created by the existing FHA condominium approval process. In some cases these provisions will provide limited flexibility to qualified condominium associations. This is a welcome improvement, but falls short of what FHA could accomplish through a more transparent dialogue with stakeholders.

We hope that the issues we have raised in this letter can be addressed by FHA in a timely manner to ensure that associations can continue to have access to FHA insured mortgages. We appreciate

the dialogue we have had with the FHA program staff and look forward to continuing our dialogue on the condominium insurance program. CAI continues to encourage FHA to engage in a more transparent process in developing future guidance. Many of the issues raised in this letter could have been addressed prior to implementation which would have minimized problems with implementation. To this end, please do not hesitate to contact me or Andrew S. Fortin, Esq., CAI's vice president of government and public affairs, at (703) 970-9220, if we can provide any supplemental information or views on guidance or on any other topics related to community associations.

Sincerely,

Thomas M. Skiba, CAE
Chief Executive Officer

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

October 4, 2011

The Honorable Judy Biggert
Chairman
Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515-6050

Dear Chairman Biggert:

As requested by several Subcommittee members at the hearing on September 8, 2011, I'm writing to explain in more detail the basis for my testimony at the hearing that if a 5% down payment requirement for Federal Housing Administration (FHA)-insured loans had been in effect during the past year, 345,000 families could have been shut out of the opportunity to become homeowners. As explained below, this statement was based on factual information available to the FHA and to lenders handling FHA-insured loans from August, 2010 through July, 2011. Our analysis of this information suggests that the 345,000 number is a conservative estimate, and that the number of such homebuyers could have been as high as 480,000, depending on the way in which the down payment requirement was structured.

Specifically, over the 12-month period of August 2010 through July 2011, FHA insured 886,700 home-purchase loans, based on loan origination and the beginning amortization date. Only 10 percent of those had Loan to Value (LTV) ratios that did not exceed 95 percent, after financing of the upfront loan insurance premium. The remaining 90 percent (794,400) either made the minimum 3.5 percent down payment, or else made as much as a 5 percent down payment but then financed their upfront premium, making the final LTV ratio greater than 95 percent. Nearly all FHA-insured borrowers finance the upfront premium, which today is one percent of the base mortgage amount.

Lenders are required to verify the amount of liquid assets each borrower has available to close the loan. They report to HUD both that amount and the assets remaining after closing. The difference between these two numbers is the required cash paid to close the loan. That cash requirement includes not only the down payment but also any loan origination fees, prepaid items, and initial escrows required of the borrower and not paid by other sources.

From this information on assets, HUD determined how many of the 794,400 borrowers with LTV ratios above 95 percent would not have had sufficient funds to pay down the loan to a 95 percent LTV and thus to provide a 5% down payment. If the upfront insurance premium is not included, then 345,000 (43 percent) would not have had the additional funds required. If the amount of financed upfront insurance premium is included, an additional 135,000 (17 percent) would not have had sufficient funds, for a total of 480,000. That number is 54 percent of all home buyers utilizing FHA insurance over the 12 month period.

As I explained at the hearing, we believe it is essential for HUD to retain the flexibility to respond to market and loan performance conditions rather than being locked into a specific down payment structure, and that a 5% requirement would adversely impact the housing market recovery and restrict access to credit for worthy borrowers. FHA has a long tradition of managing credit risk on high-LTV loans, and has insured loans with a down payment of 3% or 3.5% since 1953. Down payment alone is not the only factor or necessarily the most important factor that influences loan performance. Loan underwriting requires a balancing of risk factors rather than reliance upon any one factor. For example, the combination of down payment and FICO score is a much better predictor of loan performance than just one of those components alone. For instance, loans with an LTV ratio above 95% and a FICO score above 580 perform better than loans with LTV below 95% and a FICO score below 580, while loans with a LTV above 95% and a FICO score below 580 perform significantly worse than all other groups. It is for these reasons, rooted in a thorough review of actual FHA loan performance data, that HUD imposed FICO floors tied to down payment rates, and realigned the premium structure to rely less upon the upfront premium—which is financed into the loan balance—and more on the annual premium—which is paid monthly by the borrower.

Thank you again for the opportunity to testify on September 8th, and I would appreciate it if this letter is included in the record of the hearing. We look forward to answering any further questions that you or any other subcommittee members may have.

Sincerely,

Carol J. Galante
Acting Assistant Secretary for Housing –
FHA Commissioner

Cc: Hon. Luis V. Gutierrez, Subcommittee Ranking Member

Statement of David H. Stevens
President & Chief Executive Officer
Mortgage Bankers Association

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

"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets, Part 2"

September 8, 2011

Chairwoman Biggert, Ranking Member Gutierrez and members of the subcommittee, thank you for the opportunity to provide this statement on behalf of the Mortgage Bankers Association (MBA)[1] on the occasion of this second hearing on the future roles of the Federal Housing Administration (FHA), Rural Housing Service (RHS), and the Government National Mortgage Association (Ginnie Mae) in the single- and multifamily mortgage markets.

FHA and Ginnie Mae are pioneers of America's housing finance market. When FHA was established during the Great Depression, it served as a source of stability and liquidity during a time of financial crisis. Ginnie Mae, established in 1968, created and guaranteed the very first mortgage backed security, an instrument that continues to create liquidity for the market today. Together, FHA's and Ginnie Mae's traditional role has been to assist those segments of the population who need a little extra help in securing safe, decent affordable housing – whether through homeownership or the financing of affordable rental housing. Of late, FHA and Ginnie Mae have buoyed the nation's housing finance system during these difficult economic times. With the contraction of the private sector, FHA's market share has grown to almost 30 percent of all loan originations and has reached as high as 50 percent in some geographic locations in 2010, and almost 50 percent of all purchase mortgages in the country. Ginnie Mae, which only securitizes FHA, VA and RHS loans, has grown in turn. FHA was also responsible for 21 percent of multifamily and healthcare mortgages originated in 2010.

FHA was not immune to the challenges of the economic downturn. When the November 2009 actuarial review showed that the FHA's Mutual Mortgage Insurance Fund (MMI) had fallen to 0.50 percent in FY2010, FHA took serious and deliberate steps to strengthen its risk profile. For example, FHA made a series of single family risk management, lender oversight and enforcement changes over the last two years designed to protect the financial stability of FHA. The MBA sincerely hopes that these efforts will continue under Acting Commissioner Carol Galante and we look forward to working with her to ensure FHA remains a resource for generations to come.

In April and May of this year, MBA testified at two subcommittee hearings on the topics of credit risk retention and the role of FHA and Ginnie Mae in the single family and multifamily mortgage markets. We are pleased to have the opportunity to discuss the important link between these two issues.

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[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Credit Risk Retention and the Qualified Residential Mortgage Exemption in the Context of FHA

One of the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank) most significant provisions requires issuers of asset backed securities to retain an economic interest in a portion of the credit risk for any asset that the issuer securitizes. MBA supports the concept of risk retention and believes Congress' intent in crafting Dodd-Frank's risk retention requirements was to address errant securitizer and originator behavior inherent in the originate-to-sell model by better aligning the interests of borrowers, lenders and investors in the long-term performance of loans.

This "skin in the game" requirement, however, is not a cost-free policy option. Recognizing these costs, Dodd-Frank establishes an exemption from risk retention requirements for Qualified Residential Mortgages (QRMs). The QRM exemption was intended to recognize that traditional mortgage loans – standard products, properly underwritten and with appropriate documentation – were not the cause of the recent crisis, and securitization of these loans should remain unimpeded in order to return the U.S. mortgage securitization market to being among the most liquid in the world. By requiring a QRM exemption, the statute would keep consumer costs lower for QRMs, with higher costs for non-QRM loans. MBA believes the proposed regulations and structure of the QRM deviate significantly from what Congress intended and are likely to have a dramatic impact on the housing finance system unless they are substantially revised. MBA recommended several revisions to the proposed regulations in a comment letter submitted to federal regulators on August 1. MBA's statement today focuses on the impact of the proposed regulations on FHA.

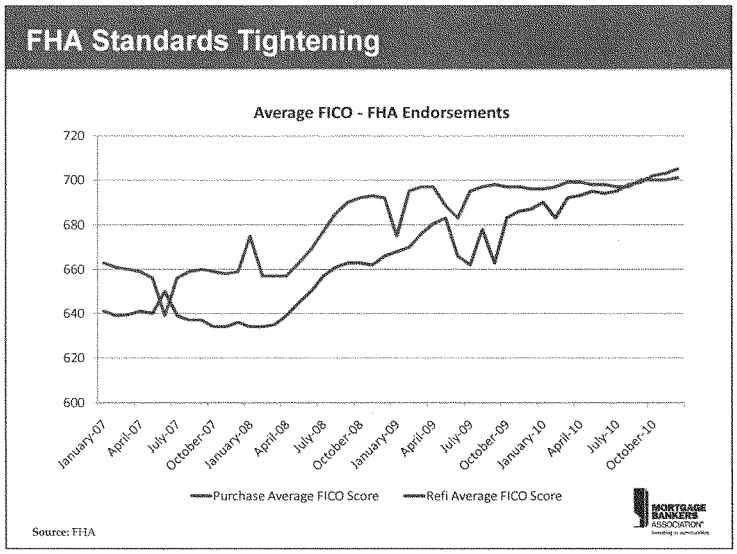
It is not at all clear from the proposal whether the regulators reflected on the relationship between the proposed QRM definition and the FHA's eligibility requirements in light of FHA's statutory exemption from risk retention.

MBA shares the belief expressed by the Obama administration in its February 2011 report to Congress, *Reforming America's Housing Finance Market*, and countless others that the role of the government, including FHA, in the housing finance market must be rolled back. Yet, the proposed QRM definition produced by the six regulators appears to conflict directly with the administration's plan for reforming the housing finance system, as it would make it more difficult for private capital to re-enter the housing finance market.

We support FHA's role as a source of financing for first-time homebuyers and other underserved groups. However, because of the wide disparity between FHA's downpayment requirement of 3.5 percent and the currently proposed QRM requirement of 20 percent, MBA is concerned that the FHA programs will be over-utilized.

With the risk-management changes to FHA coupled with stricter underwriting standards by lenders, access to credit, even in the government-supported mortgage market, is tightening. Today, the average credit score for FHA borrowers is significantly higher

than prior years, indicating lessening availability and affordability of sustainable mortgage credit for underserved and first-time homebuyers that FHA traditionally serves. We are seeing similar trends for conventional market loans backed by the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.



As the nation continues to work through the worst economic crisis in a generation, the MBA urges policy makers to allow the FHA to continue playing a countercyclical role by extending the higher conforming loan limits, which will be discussed later in this statement. In the long term, however, MBA firmly believes it is not in the public interest to allow government insurance programs like FHA to dominate the market, especially if private capital is available to finance and insure mortgages that exhibit a low risk of borrower default. We all share the belief that private capital must be given room to return to the market at the appropriate time and setting up a system where FHA logically becomes the primary source of mortgage financing will hinder the market recovery.

MBA also supports the FHA as a resource for low- and moderate-income buyers, including most first-time homeowners, and we urge policymakers to avoid taking steps that would eliminate access to FHA for those individuals – such as adopting a QRM definition with hard-wired characteristics that will make it more difficult to offer qualified consumers affordable mortgage products.

MBA suggests a better solution to meeting the requirements of Dodd-Frank is to allow the use of credit enhancements, such as private mortgage insurance, to offset part of

the down payment requirement for QRMs to provide some of the financing for low down payment loans that FHA would provide.

Furthermore, MBA believes that the Qualified Mortgage (QM) proposal issued by the Federal Reserve is a better starting point for achieving Dodd-Frank's goal of ensuring that the market originates safe, sustainable mortgage products than the QRM proposal.

Section 1411 of Dodd-Frank prohibits making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated, that the consumer will have a reasonable ability to repay the loan, including any mortgage related obligations. Section 1412 provides that if the loan meets the QM definition, it is presumed to meet the ability to repay requirements. The CFPB is charged with prescribing rules to implement Section 1412.

By statute, FHA-insured mortgages – because of their stringent underwriting requirements and the statutory definition of points and fees – meet the definition of a QM.

MBA believes that because the QRM and QM constructs were intended to achieve the same purpose of ensuring better, more sustainable lending, both constructs should be essentially the same. If a QM definition is well structured as a bright line safe harbor, it will be the chosen means for lenders to comply and, therefore, the best way to incent the sound underwriting mandated by Dodd-Frank.

A QM safe harbor will increase the availability and affordability of credit for the largest number of qualified borrowers, without establishing hardwired numerical limits. The QRM proposal, on the other hand, would have the effect of excluding a large number of borrowers from the most affordable, sustainable mortgage products and directing them into FHA-insured mortgage products.

The Role of FHA in the Single and Multifamily Mortgage Markets

In May, Michael D. Berman, CMB, the Chairman of the MBA, had the opportunity to testify before this subcommittee on this important topic. Mr. Berman's testimony included an extensive discussion on the importance of FHA and Ginnie Mae and called on Congress to provide FHA the information technology and staffing resources it needs as it continues to play a countercyclical role in the nation's housing market, to restore housing counseling funding by fulfilling HUD's FY2012 budget request, and to revise the National Housing Act to allow table funding of FHA-insured mortgages by permitting former loan correspondents to close loans in their name rather than that of an FHA approved lender. In addition, Mr. Berman's testimony addressed several important topics: FHA's minimum downpayment requirement and FHA loan limits for both single and multifamily residences.

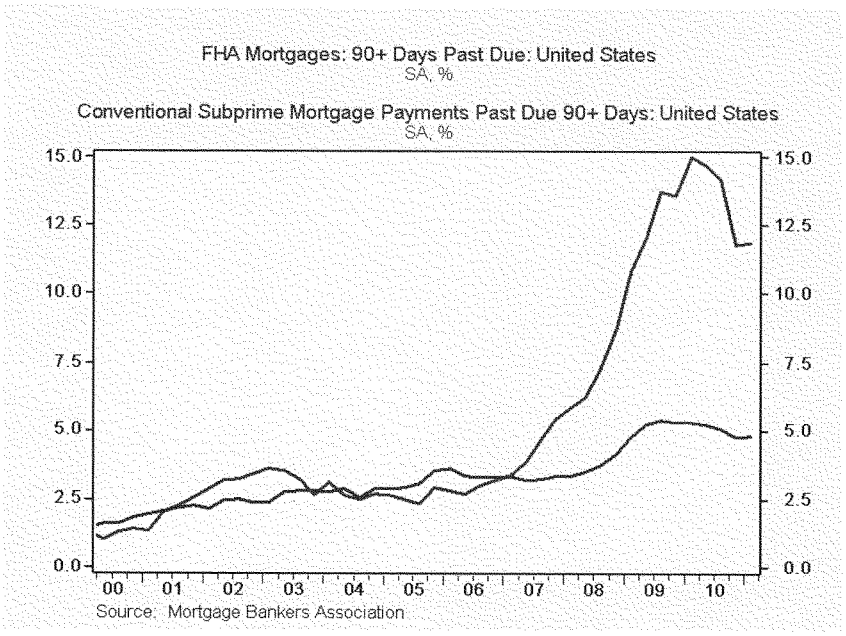
Maintain the Current Minimum Downpayment

A critical component of FHA's mission is to maintain the affordability of homeownership. The current minimum downpayment of 3.5 percent for borrowers with credit scores of 580 or above and 10 percent for borrowers with credit scores of 579 and below (a recent change to FHA policy) permits borrowers to have appropriate equity while providing credit-worthy homebuyers with an option for entering the purchase market. Maintaining the existing minimum downpayment requirements, while requiring strong underwriting standards, such as full documentation and income verification, allows borrowers to responsibly become, and stay, homeowners.

Recently, policymakers have focused on required minimum downpayments as a measure of what factors are necessary to create sound lending practices. MBA notes that data show that the principal determinant in the rate of default is the quality of underwriting standards, not the down payment. While loans with higher loan to value ratios may pose greater risks, these risks can be mitigated by compensating factors such as strong credit and appropriate documentation. Importantly, FHA's requirement of full documentation of all loans and limited loan product options helped insulate the MMI Fund from experiencing the devastating default rate during the height of the housing crisis. As the following chart below illustrates, for most of the past decade, FHA loans have performed better than subprime loans, with the exception being the years where FHA problems were dominated by the now defunct Seller-Funded Downpayment Assistance Program. Over the course of the crisis, delinquency rates on subprime loans have far exceeded rates on FHA loans.

FHA's traditional business has typically performed well and its product, credit, and documentation standards have been important contributors to this solid performance. And, even in the midst of this economic crisis, the quality of FHA borrowers has actually improved – with average borrower credit scores being the highest they have been in the history of the program.

MBA cautions policymakers to carefully weigh the socioeconomic costs of decreasing risk by raising the minimum down-payment versus the certain and dramatic negative impact on the availability of loans to low-to-moderate, first-time, and minority homebuyers.



Loan Limits

The discussion draft bill that is the topic of today's hearing would change the calculations of the FHA single-family loan limits to 125 percent of the area median home price of each county, not to exceed the GSE loan limit of the area.

Preliminary calculations indicate that the impact of this would be a decrease in consumer buying power in most areas across the nation. During this time of constriction in the credit markets, the MBA would urge the subcommittee to reconsider this proposal, which would severely limit access to mortgage credit to millions of borrowers.

The maximum loan limits for Fannie Mae, Freddie Mac, and FHA are currently $417,000 with a temporary limit of up to $729,750 for one-unit properties in high-cost areas. The temporary high-cost area limit was first set in the Economic Stimulus Act of 2008, and was extended in subsequent legislation. These limits expire on September 30, 2011. Without an extension, the high-cost loan limit ceiling would revert back to the limits established under the Housing and Economic Reform Act of 2008 (HERA), a maximum

of $625,500 in high-cost areas. This would mean that FHA-insured loans would be available to fewer individuals seeking to buy or refinance homes in certain parts of the country.

The Obama administration stated in its housing finance reform white paper that it will not support another extension of the higher loan limits and MBA understands that many in Congress agree with this position. At the time that document was authored, however, the expectation was that the economy had reached bottom and that the nation was poised for economic growth. Unfortunately, that has not been the case.

While in the long term the MBA would like to see a reduction in the conforming loan limits so that the federal government's footprint in the housing finance market can be reduced, in the short term a reduction in the loan limits will ultimately result in less access to mortgage credit across America. Therefore, MBA believes the higher limits should be maintained until the housing market stabilizes and the private market shows more signs that it has returned and is willing to lend to a full range of credit worthy borrowers in communities across the nation.

Importantly, if Congress elects to provide another temporary extension to the higher loan limits, MBA would urge that legislation be enacted quickly to avoid further market disruption. Due to the uncertainty surrounding this issue, many lenders have already curtailed originations in an effort to ensure timely closings.

Increase Multifamily Loan Limits

FHA's statutory limits for multifamily financing, while sufficiently high in most markets, are severely restricting the ability of rental property owners in high-cost urban markets to use FHA insurance programs. In the prior Congress, MBA worked with the House to pass H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act of 2009, on September 15, 2009, and as an amendment to H.R. 5072, the FHA Reform Act of 2009, on June 10, 2010. These bills, along with S. 3700, which was introduced in the Senate on August 4, 2010, would have increased the FHA loan limits for elevator properties in extremely high-cost areas. Because many MBA members originate loans in markets with higher labor, material, regulatory and land costs, there is a gap between the mortgageable amount needed to finance construction or substantial rehabilitation of units in the nation's major cities and HUD's statutory loan limits for multifamily properties. High-rise elevator buildings also serve the senior population, especially in older urban markets. MBA strongly supports providing the HUD Secretary additional discretion to be used in extremely high-cost areas (similar to that provided in Alaska and Hawaii today).

Conclusion

We urge Congress to remain vigilant in its regulatory oversight to make sure that efforts to provide a safe and sound housing market do not lead to an overreaction that risks

making sustainable mortgage credit unnecessarily costly and unavailable to far too many families.

MBA believes the proposed risk retention and ability to pay regulations would lessen competition, increase the cost of credit, and harm the very people they were designed to protect. We believe significant adjustments must be made in concert with, or at least conducive to, comprehensive reform of the government's role in the housing finance system in order to facilitate the provision of sustainable mortgage credit to the widest array of qualified borrowers at the most affordable costs.

We respectfully urge Congress to carefully monitor these and other regulations implementing Dodd-Frank to make certain they do not unwittingly harm American families, the mortgage market or the nation's economic recovery. These factors are particularly important as this subcommittee continues its examination of potential changes to the FHA, RHS, and Ginnie Mae program areas.

Testimony presented to the
Subcommittee on Insurance, Housing and Community Opportunity
House Committee on Financial Services
U.S. House of Representatives
on the draft, "FHA-Rural Regulatory Improvement Act of 2011"
September 8, 2011

The National Low Income Housing Coalition is pleased to submit comments on the proposed legislation, the FHA-Rural Regulatory Improvement Act of 2011.

Our members include non-profit housing providers, homeless service providers, fair housing organizations, state and local housing coalitions, public housing agencies, private developers and property owners, housing researchers, local and state government agencies, faith-based organizations, residents of public and assisted housing and their organizations, and concerned citizens. The National Low Income Housing Coalition does not represent any sector of the housing industry. Rather, NLIHC works only on behalf of and with low income people who need safe, decent, and affordable housing, especially those with the most serious housing problems. NLIHC is entirely funded with private donations.

Section 13 of the draft bill would transfer the U.S. Department of Agriculture's Rural Housing Service to the Department of Housing and Urban Development. Under the draft bill, the HUD Secretary would have an 18-month transition period to transfer all functions, personnel, assets and liabilities of RHS to HUD. Within 60 days of the bill's enactment, the HUD Secretary would have to submit a transfer plan to Congress.

After considering this proposal, NLIHC urges the Subcommittee to delay action on this measure until it can be examined more fully. While there may be reasons to shift RHS programs to HUD, very few of them are readily apparent to those in our broad network. Instead, after conversations with our members, a long list of potential downfalls is at hand. NLIHC would not support the proposal moving forward at this time.

Rural Housing Service Part of Integrated Rural Development Work
A key concern with the proposal to shift RHS to HUD is the resulting disconnect between RHS and its current base, the USDA's Office of Rural Development (RD). RD offices across the United States administer the Rural Utilities Service, a critical community lynchpin in the creation and preservation of affordable housing.

Again and again, NLIHC has heard from our members that the array of products administered by state RD offices ensure that rural water, sewer, telecommunications, and other infrastructure components work in tandem with rural housing resources. Likewise, RD's administration of community facilities loans and grants, which help build child care centers, fire and police stations, hospitals, libraries, and schools, etc., can today work hand-in-hand with RHS, maximizing USDA's community and economic development impact in rural areas.

Besides RHS, other RD functions would remain at USDA under the proposal. Here, we see the rural housing programs torn from their best partners, those that coordinate housing development with child care centers, utility infrastructure with new development, and so on.

Rural Focus

Another key area of concern is the potential to lose RHS's complete focus on rural needs and rural solutions, as they can differ significantly from their more urban counterparts. NLIHC's partners describe RHS's "personal touch" and intimate familiarity with local properties and projects. In addition, RHS's knowledge of its housing and community development projects bring a strong commitment to preservation, a key tool in addressing rural America's affordable housing needs.

There are also many concerns about thrusting RHS onto a Department that does not have the same roots into our nation's most remote areas. These fears, if realized, could mean a loss of attention and solutions for some of the country's most struggling communities. If HUD were to take on such a broad reach, it is also quite unclear to our members where any cost savings would be generated. Rather, the proposal could result in increased costs as HUD works to recreate the connections now operating at RHS.

At this time, NLIHC would oppose any legislation to transfer RHS to HUD. We look forward to continuing a conversation started by this draft that explores the pitfalls and opportunities of moving RHS to HUD, but believe the proposal needs significant additional exploration.

Thank you for considering our comments.

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