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THE FHA REFORM ACT OF 2010

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

MARCH 11, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–110

U.S. GOVERNMENT PRINTING OFFICE

56–774 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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THE FHA REFORM ACT OF 2010

Thursday, March 11, 2010

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

The subcommittee met, pursuant to notice, at 2:09 p.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Velazquez, Maffei; Capito, Neugebauer, and Jenkins.

Also present: Representative Garrett.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order.

Good afternoon, ladies and gentlemen. I would like to thank the ranking member and other members of the Subcommittee on Housing and Community Opportunity for joining me today for this hearing on the FHA Reform Act of 2010.

This is our third hearing on the Federal Housing Administration since October of last year. During those hearings, we learned about the state of FHA's capital reserve levels, which dropped below the 2 percent threshold mandated by Congress to .53 percent, along with the efforts FHA has taken to tighten controls over risk.

Today, we are here to discuss the additional steps FHA would like Congress to take to ensure FHA's long-term financial solvency during what some observers are referring to as the housing equivalent of a 500-year flood.

First, FHA would like to increase the cap on the annual mortgage insurance premiums it can charge in order to boost capital reserves. The bill would allow FHA to increase the cap from .55 percent to 1.55 percent for new borrowers, with downpayments below 5 percent. However, FHA has said that they will only raise annual premiums to .90 percent, and would also use their existing authority to lower the up-front premium back down.

As I understand it, if FHA limits the premium increase to .90 percent, new borrowers would only see their monthly payments rise by $42 a month. I believe that limiting the premium increase balances the need to keep FHA financially solvent while minimizing the impact on new borrowers. However, I would like to hear more information from the Commissioner about the circumstances under which FHA would need to raise annual premiums to 1.55 percent of the loan balance.

Second, FHA is also seeking the authority to crack down on lenders that use fraud or misrepresentation or don't originate or underwrite loans in accordance with FHA requirements. In addition, FHA would like the ability to withdraw originating and underwriting approval for a lender nationwide based on the performance of one or more of its regional branches.

These legislative provisions will help FHA continue its increased policing of problem lenders. FHA has already stepped-up enforcement, withdrawing 10 times as many lenders from FHA approval in 2009 than the last Administration did in 2008.

I have been long committed to ensuring that FHA remains an available, affordable, and safe option for all families. I wrote legislation to modernize FHA, which was included in the Housing and Economic Recovery Act of 2008. I also worked with Representative Speier of California and Representative Driehaus of Ohio on legislation to keep subprime lenders out of FHA, which was incorporated into the Helping Families Save Their Homes Act of 2009.

I look forward to continuing to work on sensible legislation that will balance the requirement to restore FHA's financial solvency with the requirement that we need to keep FHA available to a wide variety of Americans, including low-income, minority, and first-time home buyers.

However, as we move forward, we need to be cautious that we do not overcorrect and end up curtailing the role of FHA to the point where homeownership is only available to the wealthiest households.

I am eager to hear the testimony of our witnesses today. And I would now like to recognize our subcommittee ranking member, Ms. Capito, to make an opening statement.

Mrs. CAPITO. Thank you. I would like to thank Chairwoman Waters for holding this hearing today on an issue that I believe deserves immediate attention and action by this committee, and that is reform of the Federal Housing Administration.

As my colleagues know, last fall, Housing Commissioner Stevens testified before this subcommittee on the challenges faced by FHA's Capital Reserve Account, which fell below the mandated 2 percent of FHA insurance in force. Not only had the account fallen below 2 percent, it fell to .53 percent of the total insurance in force.

Clearly, this is a wakeup call for Congress and the Administration. And if we don't take the steps necessary to shore-up the FHA Insurance Fund, we will be facing another taxpayer bailout.

I am encouraged by the steps that Commissioner Stevens has already taken to resolve the problems facing the FHA. He has made several administrative changes and is moving forward with additional regulations to address the difficulties at FHA, such as increasing the up-front premiums, raising the downpayment for low FICO score borrowers, and reducing seller concessions.

In addition to the administrative and regulatory changes, the Administration is seeking legislative changes to increase the annual premium and increase enforcement on FHA lenders.

I support the Administration's efforts, but we can do more. Last night, I introduced H.R. 4811, the FHA Safety and Soundness and Taxpayer Protection Act. This legislation builds on the Administration's legislation by making the chief risk officer a permanent

member of the FHA Commissioner's team—and I commend him for appointing his current chief risk officer—and giving the Commissioner the ability to contract out to properly analyze risk, and enhancing the Commissioner's ability to temporarily suspend lenders who have high rates of early defaults.

Additionally, my legislation includes a pilot program for risk-based pricing, something I have talked about in the subcommittee before. I realize the Commissioner and I may not see eye-to-eye on this issue, but I hope that we can work together to find some common ground and the flexibility needed to implement risk-based pricing.

As the housing market recovers, and the FHA program returns to a more normal percentage of the total market, risk-based pricing would be an important tool, I believe, for the FHA to have in their arsenal.

Finally, I think it is important to note recent CBO re-estimates of the Administration's Fiscal Year 2011 budget. The Administration's submitted budget estimated that FHA and Ginnie Mae receipts would be $6.9 billion. These receipts were used to offset a $48.5 billion HUD budget.

CBO has just this past week re-estimated the FHA and Ginnie receipts to be only $2.5 billion, a $4.4 billion shortfall. CBO has said that the discrepancy between OMB and CBO can be attributed to the fact that CBO uses higher prepayment and default rates and lower recovery rates.

But this raises significant concerns, again, on the FHA's ability to analyze its book of business. I hope the Commissioner will take some time and address this issue for us today.

I look forward to working with the chairwoman and Chairman Frank and the Administration to enact these common-sense reforms included in my legislation, H.R. 4811. This legislation incorporates the majority of the provisions announced by the Department, along with additional provisions designed to give HUD the tools it needs to adequately administer the program and protect the taxpayer.

Thank you for being here today, and I look forward to hearing from you and the other witnesses on the panel. Thank you.

Chairwoman WATERS. Thank you very much.

Representative Maffei, for 2 minutes.

Mr. MAFFEI. Thank you, Madam Chairwoman. I am very pleased that you called this hearing. I think it is very important.

I do think it is going to be very valuable to have our questions answered. I have several constituents, actually, who have a lot of concerns about many of these proposed policy changes. And I would say that it comes down to them being worried about the unintended consequences of some of them. One of the largest, perhaps, is that small mortgage lenders may be put at a disadvantage compared to large mortgage lenders, and in fact may not even be able to stay in business compared to some large ones because of some of the proposals.

And I am writing the Secretary on this, and I actually would ask unanimous consent that I could just put my letter to the Secretary in the record.

Chairwoman WATERS. Without objection, it is so ordered.

Mr. MAFFEI. Another unintended consequence is potentially a slowdown in the economy. I mean, obviously we want to make sure that we avoid a next housing crisis. But we don't want to get in the way of perhaps an economic recovery that is on the way. And I also remain concerned about whether these changes will necessarily fully address what actually happened, and I share that with the Ranking Member.

My district is actually pretty unique, I suppose, in that we actually had very little subprime lending, much less predatory lending than virtually anywhere else; as a result, lower foreclosures. This isn't because we are a wealthy area; in fact, quite the opposite. We never had any real estate boom in upstate New York, and so we never had the bust.

And the problem is, as the constituent groups come in, whether they are Realtors, small business, small mortgage lenders, etc., and they look at the changes and they go, well, we didn't have any of these things, and these changes would, in effect, slow down our real estate market, which is not in need of slowing down, frankly. It is in need of speeding up.

And so I am a little concerned about sort of the one-size-fits-all approach. I am not sure if it is avoidable. And again, I believe these are unintended consequences. I think you have done a lot of work here. But I do have some questions as regards how these will affect my constituents.

Thank you very much. Thank you, Madam Chairwoman.

Chairwoman WATERS. I am pleased to welcome our first distinguished guest. Our first witness will be the Honorable David Stevens, Assistant Secretary for Housing and Federal Housing Commissioner, U.S. Department of Housing and Urban Development.

I thank you for appearing before the subcommittee today. An without objection, your written statement will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony. Thank you.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. STEVENS. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify here today regarding the Federal Housing Administration's recent reforms, legislative proposals, and contributions to the HUD Fiscal Year 2011 budget request.

I appear before you at a moment when it is clear that our housing market has made significant progress towards stability. As of September, stabilizing home prices and lower financing costs had increased home equity by over $900 billion, $12,000 on average for the Nation's 78 million homeowners.

Confidence deriving from increased home equity has helped the economy grow at the fastest rate in 6 years and create jobs. Historically low mortgage rates have spurred a refinancing boom over the past year that has helped nearly 4 million borrowers save an average of $1,500 per year, pumping $7 billion annually into local economies and businesses.

FHA has been an essential part of this improved outlook, in the past year helping more than 800,000 homeowners refinance into stable, affordable, fixed-rate mortgages, protecting an additional half-million families from foreclosure, guaranteeing approximately 30 percent of all home purchased loan volume in America and fully half of all loans for first-time home buyers.

Indeed, as access to private capital has contracted in these economic times, borrowers and lenders have flocked to FHA. The increased presence of FHA and others in the housing market, including Fannie Mae and Freddie Mac, has helped support liquidity in the purchase market, helping us ride through these difficult times. And with FHA financing 51 percent of African-American homes purchased in 2008, and 45 percent of Latino homes, FHA is far and away the leader in helping minorities purchase homes.

With FHA's temporarily increased role, however, comes increased risk and responsibility. Last October, I detailed to the subcommittee several of the reforms we had made to date to mitigate risk and replenish FHA's capital reserves, which have fallen below the congressionally mandated 2 percent.

On January 20th, we proposed additional steps, some of which will require legislative authority. Thank you for the opportunity to explain these proposals in more detail.

These policy changes balance three guiding principles: first, improving FHA's loan performance and capital reserves; second, continuing to support the broader housing market and recovery; and third, preserving FHA's traditional role in providing homeownership opportunities to responsible underserved borrowers. And I want to highlight the word "responsible."

First, we are asking Congress for authority to restructure FHA's mortgage insurance premiums, and we would like to reduce the upfront premium to 100 basis points and increase the annual premium to 85 and 90 basis points depending on the loan-to-value.

This will create more sustainability to increase FHA's reserves and facilitate the return of private capital to the mortgage market. The bill is in circulation. We have provided the subcommittee with a copy of that proposal.

If these changes are adopted during the current fiscal year, they increase the value of the MMI fund by approximately $300 million per month, which would replenish FHA's capital reserves even faster than if this authority was provided through the annual appropriations process.

We look forward to working with the authorizing committee members. We hope the appropriators and authorizers will move to pass it on as expeditiously as possible. And we certainly look forward to considering H.R. 4811 and how that can blend into the goals of FHA.

Secondly, FHA is proposing a two-step FICO floor for FHA borrowers. Purchase borrowers with FICO scores of 580 and above will be allowed to make the minimum 3½ percent downpayment. Those with scores between 500 and 579 would be required to make a 10 percent downpayment.

Some have suggested that FHA raise the minimum requirement to 5 percent across-the-board as a way to improve loan performance. As you can see, we have gone further, to 10 percent for FICO

scores below 580 to ensure that we are only insuring responsible loans.

We determined after extensive evaluation that an across-the-board 5 percent proposal would be inadequate to control risk for some of the borrowers, and excessive to control risk for other responsible borrowers, which would adversely impact the housing market recovery.

Increasing the minimum downpayment to 5 percent across-the-board translates to 300,000 fewer responsible first-time home buyers having access to homeownership, and would have significant negative impacts on the broader housing market, forestalling the recovery of the housing market, potentially leading to a double dip in housing prices by significantly curtailing demand.

The policy changes that FHA has instead proposed in the Fiscal Year 2011 budget contribute an additional $4.1 billion in receipts to FHA, and have a much more moderate impact on the broader housing market.

The third policy change we are proposing is to reduce the maximum seller concessions from 6 percent to 3 percent, which is in line with industry norms. The current level exposes the FHA to excessive risk by creating incentives to inflate appraised value. Further, our experience with FHA with these loans is that loans with higher levels of seller concession are more likely to go into default.

Our fourth proposal is to further increase lender enforcement. In its Fiscal Year 2009 actuarial review, the independent actuarial review, the independent actuary projected that more than 72 percent of FHA's losses over the next 5 years will come from loans already on our existing books. That is why we have renewed our focus on enforcement and lender accountability.

Since Fiscal Year 2009, we have taken action on more than 6 times the number of lenders that FHA had done in the past decade. We are seeking congressional authority to extend FHA's ability to hold lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated or in which fraud or misrep was involved.

FHA currently has the authority for loans originated through the lender-insured process, which accounts for less than a third of all FHA-approved lenders. We are asking that Congress grant explicit authority to require indemnification for loans that were improperly originated for all FHA lenders.

Finally, as you know, last Friday the CBO released its estimate of the Fiscal Year 2011 budget, including the review of FHA changes. Although the CBO re-estimate includes a significantly more conservative assessment of how new loans were made through FHA's MMI fund and how it will perform in coming years, both CBO and the Administration forecast, with our proposed FHA changes, credit activities, that it will result in let receipts to the government that are positive to the government, meaning a negative subsidy. We differ, however, on the amount.

While the President's budget forecasts $5.8 billion in net receipts, resulting primarily from insurance premium and other fees, CBO re-estimates those net savings at $1.9 billion. They agreed with Ginnie Mae, and the GISRI fund will result in roughly another $1 billion from receipts.

While recognizing that such a difference with CBO complicates budget resolution development, it is important to note that the $5.8 billion in receipts forecast in the President's budget will determine any receipts transferred back to FHA's capital reserves. This will help the fund get back on track to be capitalized with the statutorily mandated 2 percent insurance in force. I would also note that we remain confident in our forecast.

I have submitted more detailed testimony for the record. But Madam Chairwoman, as you can see, we have proposed a comprehensive set of reforms to improve loan performance, hold lenders accountable, and increase revenues to the FHA fund, while ensuring that FHA continues to support the overall recovery of the housing market and continues to serve its mission of providing homeownership opportunities for responsible borrowers.

I would like to take this opportunity also to introduce two members of our new leadership team. To my left, Bob Ryan, FHA's first Chief Risk Officer; and Vicki Bott, our Deputy Assistant Secretary for Single-Family Housing. Both Vicki and Bob come with over 2 decades of experience in the housing market, and are part of the new force behind FHA.

We look forward to working with Congress closely on these issues, and we hope to gain your support for our legislative request to further reduce risk to the American taxpayer. And with that, I am happy to answer any questions you may have. Thank you.

[The prepared statement of Commissioner Stevens can be found on page 95 of the appendix.]

Chairwoman WATERS. Thank you very much. I recognize myself for 5 minutes.

Let me again welcome you to this hearing today. Allow me also to recognize that you have had to take some tough steps in order to ensure the solvency of FHA. I am appreciative for the work that you have done to do that. It was not easy for me to look at what had to be done and simply agree to it. But I recognize what has brought us to this point in this center relative to the economic meltdown and the role that subprime played in that, and so I know what must be done.

Let me also commend you on the steps that you have taken to deal with the problem lenders, the fraud and the abuse that I think helped to cause problems relative to the subprime meltdown. So the work that you are doing to police these lenders is extremely important.

Again, I like what I see. I am anxious to look at your bill, your proposals that you have. And I understand that our ranking member has something that she is working on, so we will certainly entertain that.

However, having said that, I am hopeful that we can correct the problems that we are confronted with and make sure that you are meeting the mandates that you are responsible to meet in terms of your reserve.

I want to know what factors would lead FHA to lower the annual premium back down to .55 percent? Would FHA lower their premium back down when, for example, reserve levels are recapitalized above the 2 percent level, interest rates rise, you find that minority and low-income home buyers are disproportionately excluded

from homeownership? What would cause you to take a different course to make sure that we were providing opportunity for all?

Mr. STEVENS. Thank you for your comments and your support. Let me try to talk about the fee in this context, and I would love to have Bob jump in after I make some initial comments about the fees.

I bought my first loan with an FHA loan back when rates were 21 percent, and the mortgage insurance premium back then was 3.8 percent. The fees with FHA loans have changed over time. As you recall, that period of time was also a housing crisis, which we now refer to as the "oil patch" crisis. And it resulted in high foreclosure rates and, quite frankly, is the most similar book that we see to today.

Now, we would never go back to that level; at least, I don't foresee that. But clearly, what drives the need to adjust premiums, as with any kind of insurance business, is looking at the forecasting of risk on a go-forward basis.

And today, what has impacted FHA's capital reserves so dramatically are a couple of things that are now resulting in the need to raise the fees, the most important of which is home price forecasts, home price appreciation forecasts. That is the single greatest determinant on what ultimately caused this default in the FHA portfolio.

We have seen several series of declining forecasts on home prices. Now, at present, the current home price numbers are right in line with the forecast, and so there is some reason for potential optimism. But that doesn't eliminate the fact that the risks that the portfolio has taken on in these past book years are going to cause extended losses over the years to come as these loans go through the default cycle.

And it is for that reason that we feel very strongly that the premiums must be increased, and that they need to be restructured in a way that makes it more palatable for consumers to pay on an as-you-go basis by increasing the annual premium; also, to allow an opportunity for private capital to come back in.

That being said, I would still be very clear. Just like in past years when the premiums have been higher and were lowered, you could see a point in time in future years where premiums would adjust depending on expected performance of the portfolio.

And before I let Bob just jump in, as it relates to the underserved communities that FHA has traditionally been here to serve, we pay vigilant focus on making sure the policies we implement are effective in getting the capital reserves to where they need to go, that put us in a position of ensuring responsible homeownership over the long term, but have policies that also take into significant consideration the impact to the underserved. And I can assure you that is a top objective of mine in this Administration.

Chairwoman WATERS. Thank you. My time has expired. I am going to call on the ranking member, Ms. Capito, for 5 minutes.

Mrs. CAPITO. Thank you. The FHA currently is insuring loans up to $729,750 in maximum high-cost areas, and the limits for conforming loans are similar. I think we need to look, and you have mentioned it in your statements—we need to look at how we are going to bring the private market back in, and FHA is going to step

back into maybe what would be a more traditional role for FHA and a more manageable role.

Are the higher loan limits an impediment at all to that effort of bringing the private markets back in? I know you mentioned when we had a meeting last week that this isn't really a very large part of the FHA market. But if you could speak to that issue.

Mr. STEVENS. Sure. I think that is a great question, and it is something that we look at closely. It is concerning, and particularly the point that you made about returning to our normalized level. There are two issues associated with this.

First of all, there is a complete absence, which I think we all recognize, of private capital in the mortgage finance system for a broad range of home buyers today. And the temporary limits, which today extend to 125 percent of median income up to the maximum loan amount of over $700,000, that loan amount is actually only available in select markets around the country because of the median sales price formula, home price formula.

That being said, once that expires, the temporary limits, the permanent authority is 115 percent of median income up to still a fairly high number. And that has been allocated FHA.

I think the most important thing we need to do to make sure that private capital reemerges is to create an environment where confidence and stability exists in the housing sector.

When home prices stabilize, unemployment amends, private capital will come back. Will FHA play a role in these high loan balance markets over the long run? Our expectation is that will not be the case. Even today, less than 3 percent of our portfolio is over $417,000. So we don't even see a large influx of these high-dollar loans under the current scenario.

Mrs. CAPITO. Okay. Thank you. Another question I have is on this downpayment issue. It is 3.5 percent now; for those with FICO scores of 580 and below, you have moved it to 10 percent. And again, a conversation that we had in the past, I would like for you to enumerate for me again why you don't believe that moving the downpayment up to a 5 percent across-the-board—and you address this in your opening statement—

Mr. STEVENS. Yes.

Mrs. CAPITO. —that is not the great predictor of whether there is going to be a default or whether there is not enough skin in the game.

That is an issue, that is a bone of contention, with a lot of members on my side of the aisle. And I would just like to have you on the record on that one more time, please.

Mr. STEVENS. Thank you. And I really do appreciate you asking the question because it is clearly one of the strong items that has been debated around the FHA program since I was sworn in in July.

Fundamentally—and I want to just show you some data in a moment—but fundamentally, FHA is not in the layering of risk business like the private sector was, and even to some degree the GSEs participated in, where FHA loans are all owner-occupied, all primary residence, all fully documented, and all 30-year fixed-rate fully amortizing loans.

I don't want that to be understated because the only real risk variable, aside from lenders adversely selecting FHA and making sure we have FICO guidelines in place to protect the portfolio—the only real risk variable at that point ends up being the equity portion, the downpayment portion, which we have decades of history on that portfolio and the FHA program.

Can I see which slide we have up there, please? So I want to show two slides to highlight that. The first one I think you and I went over in your office last week. This slide, if you look at the cells on the far left, that shows FICO scores below 580.

And you can see on a relative basis the performance of—and I want you to look at the upper yellow bar on that chart. It shows that the relative performance of loans below 95 percent loan-to-value are worse when you combine it with a low FICO score. Or, conversely, in the middle bar, the bottom highlighted area will show you that the performance is better at higher LTVs if you offset that with a FICO above 580.

And so the point to this slide is merely to say that when we did our analysis, we looked at making sure that responsible homeownership would continue, and that we could measure the performance variables associated with a FICO LTV mixture and DTI, which is important.

If I could just show one other slide. And which one is—yes, thank you. So what this chart highlights to you is the impact of our policy changes. And as you can see, the top line on that chart highlights that the fallout from our policy changes, that is the—those are the people who would no longer be eligible for a home loan with FHA based on our policy changes.

And you can see that their default rate is extremely high. It is over 30 percent. That is the portfolio that will no longer be able to get an FHA loan with our changes. The lower section—

Mrs. CAPITO. What is that? I can't see that, and I can't—

Mr. STEVENS. It is 31 percent, about 32 percent.

Mrs. CAPITO. Okay. Thank you.

Mr. STEVENS. Excuse me. And that is—

Mrs. CAPITO. I was trying to show off with my eyesight, but it was not working.

Mr. STEVENS. Yes. And that is the critical component when we made our decisions going through the analysis, to make certain that we didn't exclude responsible homeownership in the changes we made.

But we went further. And unlike the 5 percent downpayment suggestion that some have made, we believe that downpayment makes a difference when you have poor credit or credit histories that don't support a higher loan-to-value.

So we went further than 5 percent. We went to 10 percent down if your credit score is 580. And we have clear performance variables to correlate that with the performance histories on our portfolio through a variety of scenarios.

Mrs. CAPITO. Well, thank you. And the charts are very helpful, especially if you can see them. So I appreciate that.

Mr. STEVENS. I apologize for that.

Mrs. CAPITO. No. That is my fault. Thank you.

Chairwoman WATERS. Thank you very much.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Madam Chairwoman.

Mr. Stevens, the three major credit reporting agencies found that about 21 percent of the 11.9 million consumers who obtained subprime loans during the housing boom should have received prime loans that would have saved them thousands of dollars. Yet FHA is relying on the same system to determine new downpayment requirements.

So my question to you is: Why are you relying on such a terrible way to determine creditworthiness?

Mr. STEVENS. I think that is a wonderful question. And it really helps, I think, juxtapose what we saw during the peak of the housing boom, with the enormous growth of subprime, and what caused defaults in that portfolio versus the FHA portfolio.

And without getting too much into the weeds on all the complexities between the two, it is—without question, subprime loans perform 300 percent, 3 times worse, than FHA portfolios do. And actually, delinquency rates are rising faster even in Fannie and Freddie portfolios than FHA portfolios are on a monthly basis.

FICO is not the sole determinant. And I do respect your question. FICO is one of a variety of determinants, documentation and other. And FHA does have an alternative credit program that we have been planning to roll out on a pilot basis to test that going forward.

But that being said—

Ms. VELAZQUEZ. But 21 percent is a huge number.

Mr. STEVENS. But the real question is: Of the 21 percent who would have qualified for FHA loans, would they have even performed in an FHA mortgage? And to be clear, if you look at our 2006, 2007, and 2008 portfolios, sub-580 FICO scores have delinquency rates and expected long-term claim rates that are north of 25 percent. And in fact, in that lower FICO distribution, it even goes higher.

So the fact that those subprime borrowers could have gotten FHA loans, the one question I would ask—and we will go back and look at it even more closely, but I could show you in the FICO distribution—would they even have performed in an FHA loan? And we are seeing that same lower credit score has extraordinarily high defaults.

And my concern is if we are foreclosing on one in four borrowers or one in three borrowers as a result of policies that allow people to get into homes, we are destroying their credit ratings and describing their wealth-building capabilities by the mere act of getting them into the homeownership process too soon or when they are not ready.

So I think there is that sensitive balance that we have to be very careful of.

Ms. VELAZQUEZ. Are you taking any steps to improve the accuracy of credit scores?

Mr. STEVENS. We are. So we have met with all the credit reporting agencies, and they themselves are also going through a change in how they model credit. And it actually might be worthwhile at some point having them come in and talk about it because today, unlike in past years where the capacity was not as strongly meas-

ured in models, today they are looking at us each of credit, not just the frequency of repayment.

And we do believe that credit scores today have become more benchmarked against a real performance than perhaps some of the inflated credit scores that we saw during that past period. I don't know if that answers your question.

Ms. VELAZQUEZ. Okay. It does.

Mr. STEVENS. Thank you.

Ms. VELAZQUEZ. Mr. Stevens, many industry advocates oppose applying FHA's indemnity authority to the direct endorsement lenders for fear that it will make them overly restrictive in their lending. Given that lenders in the lender insurance program are currently subject to this authority, and are consistently the most prolific of FHA's lenders, how realistic is this concern?

Mr. STEVENS. And this is another important question that we get out in the open as we talk about it.

So first of all, today we can pursue indemnification. But LI lenders, which is what we are allowed to pursue today, only account for about a third of all originations. There are many other lenders who can get approved by FHA, and the indemnification ends up being restricted when they ultimately fund the loan and being able to go direct to them.

So we believe, like with all participants in the housing finance sector, that we should have the right to be able to require indemnification from any lender who is approved as an FHA lender, whether they are a direct endorsement lender or an LI lender, and hold them responsible for the loans they originate.

And I think it is critical for all of us, particularly when we think about many of the underserved communities that FHA has served, because we saw a propensity for lenders to prey on, sometimes, those with less comprehensive financial skills. And it is very important when we think about sustainability and responsibility, and that indemnification will go a long way to ensuring those participants understand the rules.

Ms. VELAZQUEZ. And to guard against increasing losses, FHA has proposed to increase the downpayment for borrowers with FICO scores to more than twice the amount that other borrowers pay. This is going to have a significant impact on Hispanic and African-American borrowers.

Are there any other ways for FHA to strengthen the quality of loans to these individuals without abrogating its mission to help borrowers who are underserved by the private market?

Mr. STEVENS. First, let me try to articulate the answer. And I can—the one thing that is absolutely certain is your question was fundamental to the reason why we ended up with the policy decisions we made. And so let me articulate these. And this is—again, I will try not to get too technical; what I will offer up is any follow-up information that you or your staff would like to have.

Today, the largest financial institutions in the mortgage finance sector have FICO scores that are well above 580. Most are at 620 to 640 or higher. And that includes the top five banks that originate mortgages in America, which today under a consolidating environment have an enormous impact on the overall credit availability to homeowners.

The reason why we picked 580 was based on actual loan performance. And, as I said in my opening comments, one of the lenses that we ran all our policies through was our mission, our commitment to the mission of FHA and making sure that all responsible homeowners, underserved across the country, had access to available credit.

580 will actually open up the credit box from what has happened over 2009 via the consolidation amongst these large institutions. And it is our hope that the large institutions will actually move back to our policy, which we believe will expand the market.

Now, I will tell you this, that the 580 does limit—

Ms. VELAZQUEZ. Your time has expired. That is what she is trying to tell you.

Chairwoman WATERS. A long time ago.

Mr. STEVENS. Okay. I understand the hammer.

Chairwoman WATERS. A long time ago. And we can follow up in writing, and you can respond to the members' questions.

I am now going to call on Ms. Jenkins for 5 minutes.

Ms. JENKINS. Thank you, Madam Chairwoman. I would like to yield my time to my colleague from West Virginia, Congresswoman Capito.

Chairwoman WATERS. Without objection, it is so ordered.

Mrs. CAPITO. Yes. Thank you.

A question I have: Along the same lines of increasing the downpayments, it is my understanding that you are going to increase—or that the annual—or the premium, the up-front premium, has been increased to 2.25 percent, which the buyer can then finance, can still be financed into the mortgage amount, which then, I think, this approach raises the mortgage amount facing the borrower and effectively reduces the equity that the borrower has in on the loan.

Should FHA require some portion of the up-front premium to be paid in cash rather than allowing it to all be rolled into the mortgage to then get back to the skin in the game, the more obligation?

Mr. STEVENS. Yes. We considered all aspects of the skin in the game from the home buyer when they go into a home. The one variable which we do know from a clear performance characteristic is when the borrower saves up a 3½ percent downpayment themselves, and puts it down for a downpayment, that we see a clear performance variable that is different from all others.

The mortgage insurance premium has been financed in the mortgages going back decades. We looked at it very closely. We do believe 2¼ percent being financed up-front does pose some additional risk to the portfolio, which is why one of the measures we are trying to do through legislation is to lower the up-front downpayment to 1 percent and then charge—and then increase the annual so the borrower pays as they go.

That does a couple of things. One, it plays exactly into your concern, which is a concern we share as well from a risk standpoint. But in addition to that, it will allow, we believe, more private segment participants, the mortgage insurance industry, to return to the market as well, which I think is fundamentally critical to getting this housing—

Mrs. CAPITO. Because you are lowering that up-front premium?

Mr. STEVENS. Well, the way private mortgage insurers work is they typically don't charge a large up-front premium, if at all. And they charge an annual premium, which is charged monthly in the payment.

Mrs. CAPITO. Right.

Mr. STEVENS. By us collecting it all up front, financing the loan, we are really creating a barrier for the private industry to return to the mortgage finance sector, which is an absolute priority for us. We need to create an environment where the private sector can compete, and this premium change will help them do that.

Mrs. CAPITO. Okay. In my opening statement, I talked about the difference between the CBO and the White House's number. I am not sure I quite followed your explanation of that, if it in fact it is a $4.4 billion difference there in the calculations. That is concerning, especially with the capital reserve fund being as low as it is.

Mr. STEVENS. Right.

Mrs. CAPITO. Have you looked at having an independent auditor come in and look at this and evaluate it to make sure your numbers are on target? Because I think this is going to be extremely important as we move through this year.

Mr. STEVENS. Yes. Thank you. Well, first, let me tell you how our budget was created. An independent actuary firm scores and looks at the FHA policy changes, and they do their own independent assessment of what that is going to mean to the reserves.

That ends up being submitted to the Office of Management and Budget. OMB then does their own independent assessment of what we submitted, and in fact, they made a series of changes to the numbers that the independent actuary firm came up to, although not as dramatic as the Congressional Budget Office did.

And they ended up having a different home price forecast, different severity rates, different prepayment speeds, and a variety of factors that ultimately ended up scoring it differently. It was that budget from OMB, that scoring, that went into the President's budget.

Mrs. CAPITO. Right.

Mr. STEVENS. CBO, which we are looking at closely, looked at a variety of characteristics. And we are studying those carefully. We believe that the numbers submitted in the President's budget are more accurate, and we stand by them.

We look forward to seeing what the appropriating committees do ultimately in making their decision, and how they weigh the CBO estimates against the OMB estimates because it is ultimately their decision.

But again—and if requested, I would be glad to go into further detail. But there is a variety of characteristics of the CBO scoring that we believe is worth consideration. But we stand by the OMB submission.

Mrs. CAPITO. Okay. One quick question. Would you say the single most beneficial reform that you are asking for and has been made up to this date to replenish the capital reserve is the annual premium option rather than—and then lowering the up-front premium?

Mr. STEVENS. Absolutely. So the annual premium—

Mrs. CAPITO. $300 million a month?

Mr. STEVENS. Yes. The annual premium increase has a very positive impact, obviously, to increasing receipts. The new, requested authority to go down to 1 percent and increase the annual actually produces greater receipts to the fund. Single greater impact, but I don't want to underemphasize, and I know you have it in the bill that you submitted as well, the importance of enforcement.

Mrs. CAPITO. Right.

Mr. STEVENS. Our worst books are what is going to cause over three-quarters of the losses going forward. And that was basically by bad lender behavior, preying on our portfolio. As you know, we have shut down 350 lenders in the 6 months I have been in the job. That is, you know, far and away multiple times more than what was done in the previous decade.

We are getting the bad players out. But through authority by legislation, we will be able to do more. That has a huge impact on institutions preying on your portfolio that have equal impact.

Mrs. CAPITO. Thank you.

Chairwoman WATERS. Thank you.

Mr. Maffei?

Mr. MAFFEI. Thank you, Madam Chairwoman.

Commissioner, thank you very much for being here today. I first want to just ask about the reduction in the allowable seller concessions from 6 to 3 percent. I understand the difficulty with the seller concessions. It increases the amount borrowed often, and, given a tough economy as we have seen in many parts of the country, most parts of the country, a reduction of housing prices can lead to some difficult results.

I guess my question, though, is: Are we being a little bit reactive in terms of cutting it in half? And particularly cutting it in half immediately with no phase-in whatsoever.

I am concerned because as we do see the housing market start to recover, I don't want to, as I said in my opening statement, have a policy that kind of artificially reduces the amount of sales that there are, slowing down the housing market and not necessarily completely avoiding the problem anyway since you are still going to have seller concessions.

I am wondering where the FHA is at all amenable to some—either making it more gradual or making it less severe or something like that over time. And if you can address my concerns?

Mr. STEVENS. Thank you for the question. First of all, let me just say that this will go out for open comment, and there will be a 30-day comment period. And you have members of the National Association of Realtors on the next panel, Charles McMillan and others, who will express, I am guessing, their concern about the seller concession.

Mr. MAFFEI. That might be—yes.

Mr. STEVENS. Let me just be very clear that our concern on seller concessions, in a similar way to other programs that have involved the seller in the financing of a home, is that we clearly can correlate seller concessions, high seller concessions, with performance.

And it is our belief that high seller concessions that are higher than what Fannie Mae, Freddie Mac, and other industry players do artificially inflates the value. Or, put another way, if a seller is

going to sell a home, and their bottom line is $200,000, and they are being asked to pay a 6 percent seller concession, 3 percent more than they would normally do for any other lender, we believe that 3 percent extra basically will ultimately show a $206,000 sales price or something along those lines.

In other words, when the seller is participating in the financing of the home, you lose that arm's length independence. In addition to that, the fact that we are unique in allowing higher concessions provides opportunity for FHA, and ultimately the taxpayer, to be adversely selected.

I have spoken to the real estate industry nationally. I have spoken to home builders nationally. I know there is concern. But the one thing I will assure you, and I have the data in front of me: The performance on 6 percent seller concessions is 1½ times worse on the total portfolio than those with 3 percent seller concessions. That turns into very significant claims numbers for the portfolio with no additional insurance coverage for FHA.

So the comment period is there. We will absolutely listen during the comment periods. And I assure you we will be glad to respond further if there is—

Mr. MAFFEI. What about—obviously, it maybe needs to be corrected. But what about some sort of transition period so it doesn't have an adverse effect on the economy or on particularly home sales recovering in the near term?

Mr. STEVENS. I think you make a very good point. We need to—in the comment period, if that is suggested, we will take everything under consideration.

FHA, in my view, coming into this position has multiple years of deferred maintenance where no changes were made to the portfolio, and it is suffering the consequences today. We do not have the luxury to not make the changes that are absolutely necessary to ensure performance and make FHA a responsible, trusted financial services vehicle in the system, particularly since the taxpayer is backstopping it.

The performance is too clear on this. However, again, I am very open to seeing what comes back during the comment period. We remain very engaged, and I have an open door policy to the industry to come in and express their concerns.

So we will listen as we go forward. And I take that, and we will listen to your recommendations.

Mr. MAFFEI. Yes. And you may hear from me as well.

On the increase in net worth requirements for mortgage lenders, this is particularly concerning to some of the mortgage lenders in my district who tend to be quite small. They are family-owned businesses, frankly, you know, a couple of people.

And it is not—it is not that it be raised at all. It is just that, again, you are going from a dramatic raise of increased net worth from $250,000 to $2.5 million within 3 years. I am very worried that is going to crowd out smaller mortgage brokers. I am very worried it is going to reduce competition.

It also could chill sales of homes, which, by the way, would then keep home values low if they are not selling and combine to the rest of our problem.

So we would like you to address that, and also if you could give me your opinion of—the National Association of Mortgage Brokers, I believe, has a proposal to at least increase the phase-in period.

Mr. STEVENS. We received a large volume of comments during the comment period on this rule. We have the comment period, it has ended, and we are planning on releasing the rule here in the near term.

So I want to assure you that we listen to those concerns. As I hope you are aware, our rule planned to go to a million dollars initially, of which 20 percent of that has to be tangible capital. So our capital rule that we are initially rolling out is actually far lower than what most institutions require.

In my role in the private sector, I ran a small mortgage banker for a period of my career, and we had $7 million in capital for a fairly low amount of volume because it was required by our warehouse lender to hold that in reserves.

I feel very confident that the final rule will take into consideration the concerns the like of which you just suggested. And while I can't state what is going to be in the final rule, obviously, because it is not released yet, I think that point has been heard loud and clear.

Mr. MAFFEI. I appreciate it, Commissioner. And if the committee would just indulge me for a minute, my concern, though, is again, because of the recession, it is a lot harder to come by capital right now. And so an increased transition would be very helpful there. Thank you very much.

Mr. STEVENS. I appreciate your comments.

Chairwoman WATERS. Thank you.

Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Madam Chairwoman, and Mr. Stevens for being here.

I want to go back to the new policy of the 10 percent downpayment on FICO scores of 579 and, I guess, lower. How many borrowers—how many loans have you approved with people—let's just say the first—nearly the first quarter of this year. How many loans have you approved with FICO scores of 579 or lower?

Mr. STEVENS. A very small percentage, and I will get you the exact figure. But let's assume it is less than 3 percent today.

But if I could, those books are scoring at very high rates that even the CBO, which is the most conservative estimate, expects to produce positive revenue to the taxpayer. What the problem has that occurred at FHA is we have—a large percentage of the portfolios from 2006, 2007, and 2008 were well below 580. And they have cumulative default expectations of in the mid-30 percent range on those sub-580 portfolios.

And my fear is not to tighten up from what is coming in the first quarter of this year; FHA is insuring the best quality book it has ever insured in history. In history. But my concern is that as competition reemerges and lenders do what lenders do, that they will go back down the credit score chain again, once again, to compete.

And we saw it so clearly, even, last year when I first got sworn in. Taylor, Bean & Whitaker was competing at credit scores well below 580, even though the large institutions weren't there. And they were our third largest issuer in 2009.

And so what this floor will do is it is not—I don't think the goal is to stop the quality of borrower coming in today. It is to protect FHA so that these terrible books from 2006, 2007, and 2008, which are causing the vast majority of our default problems, never can reemerge. And that was the purpose.

Mr. NEUGEBAUER. I am glad you brought that up because I would be interested. I am sure you are tracking this because you have the numbers. But if you could furnish me a bracket of FICO scores and your default rate within those FICO scores to get a handle on that. And also, if you could give us an origination percentage within those FICO scores.

Mr. STEVENS. I would be happy to do that.

Mr. NEUGEBAUER. The other issue is that in 2008, Congress, as you know, banned third party seller-funded downpayment assistance to groups that were participating with FHA.

I think you alluded to that a little bit, but I would like for you to repeat what you just said. That is where some of your higher default rates are? Is that correct?

Mr. STEVENS. That is correct. Seller-funded downpayment assistance loans account singly for our worst default experience in the worst book years of FHA. And I do want a caveat. I have had several meetings with Congressman Green where he is eager to see if there is a way to look at a pilot that might reemerge the program.

I can tell you from professional experience in my history and what is clearly evidence in the FHA portfolio that the seller-funded downpayment assistance loan was a bad loan. It is producing cumulative expected claim rates north of 30 percent. Our current 30-plus delinquency rate on that portfolio alone is 35 percent.

So we are getting close to one in two; we are over one in three borrowers are in delinquency. And I think that loan particularly preyed on select communities in this society. It was not sustainable.

It was bad for homeowners who are going to have their credit ultimately wrecked by the program. And I thank Congress for eliminating that program at the beginning—effective the beginning of 2009.

Mr. NEUGEBAUER. Yes. I think you made a good point. I think the purpose of FHA was to promote homeownership. But it was also really designed to promote sustainable homeownership. And, I think we get focused sometimes on what the owned housing percentage is and how many Americans own. And certainly that is the American dream.

But housing is in really two forms. People can rent and people can own. But I think what we need to focus on, and we did a great injustice to a number of people, was that—and I think the United States Congress was as guilty as anybody—is we have to get that ownership percentage up at any cost.

The only problem with that was is the American taxpayers, depending on what you are able to do with the fund, may ultimately have to pick up this tab. But they have already picked up the tab in loans outside the FHA realm.

So—is my time already up?

Chairwoman WATERS. Yes, it is.

Mr. STEVENS. Could I make a quick response?

Mr. NEUGEBAUER. Yes, please.

Mr. STEVENS. I appreciate your comments—

Mr. NEUGEBAUER. That other information, if you can follow up with—

Mr. STEVENS. We will get you the information.

Chairwoman WATERS. Without objection, Representative Garrett will be considered a member of this subcommittee for the duration of this hearing.

You are recognized for 5 minutes.

Mr. GARRETT. Thank you. And the duration of the hearing will be probably just 5 minutes, then.

[laughter]

Mr. GARRETT. Two or three quick questions. The first one I think you may have touched on before I came in. I am going to be going to budget next week—I think you touched on this; I would like to hear your answer in a little more detail.

OMB has a figure of $6.9 billion. That is a little bit above what—Ginnie Mae at actually 5.8; CBO has 1.8. I was watching the TV when someone at the Blair House was saying that if we can't go by CBO scores and we don't have one place we can go to that is nonpartisan or is bipartisan and what have you, as far as relying on their numbers, then we have no place to go.

Why should we not be looking to the CBO number on this at 1.8 as opposed to the 5.8 that the Administration comes out with?

Mr. STEVENS. Thank you for the question. I have to admit I am a private sector person who has come into government in July to take on this role, and facing—

Mr. GARRETT. Good luck.

Mr. STEVENS. —facing the FHA challenges. So, honestly, comparing the validity of CBO over OMB, I think, having gone through the analytics of the FHA portfolio, which we have had reviewed by multiple participants both within the Administration and outside, there are varying views on how any change scores.

And it has to do with prospective views of home price forecasts, severity rates, default rates—

Mr. GARRETT. Prepayment rates.

Mr. STEVENS. —prepayment speeds, all those variables, and interest rates.

Mr. GARRETT. And is that all considered by the OMB numbers in—but obviously—

Mr. STEVENS. Yes. In fact, the OMB numbers disagreed with IFE, who is the independent actuarial firm, a well-known nonpartisan individual actuarial firm that did the FHA independent work. And I am sure another firm would look at it slightly differently.

They all score with positive receipts. Clearly, CBO's is concerning.

Mr. GARRETT. Okay. Along that line—and maybe you have this—but a recent academic study on the FHA MMI fund report raised questions about the claims assumption for FHA's refinanced loans, as well as the accuracy of the actuarial modeling used by the FHA when they found the MMI fund at below the 2 percent minimum capital requirements, still greater than zero.

Additionally, Federal budget documents made clear that the FHA has consistently underestimated its claims for years, and that model changes to the FHA actuarial model have had to be made to account for some $37 billion in reestimated costs.

And so maybe your answer to this one is a quick "yes." Is the FHA willing to consider an independent review of the current actuarial models so that Congress can feel more confident in the numbers that it receives?

Mr. STEVENS. Thank you for the question. There is no question that there is risk in the FHA portfolio.

Mr. GARRETT. Right.

Mr. STEVENS. I said it when I was being sworn in for this job, and in testimony. So we are all concerned about the risk, and we are concerned about variability of outcome. And certainly if Congress chose to have an independent look, that would be your purview to do so and we would welcome that.

Mr. GARRETT. So even without us taking all the rigmarole of a congressional action?

Mr. STEVENS. I am very open to the idea. I want to make sure we do it under appropriate controls, and that it doesn't create another problem, a unintended consequence that I am unaware of.

But I really do encourage people to have access to our information. And just in relationship to the study that was recently done, an academic study, the one that I am guessing you are referring to, it is interesting. It is another one of many.

I have seen a lot of studies done that raise concerns about the FHA. Nobody is more concerned about FHA risk than Bob Ryan, Vicki Bott, and myself, and the new team who have come in to look at this.

That is why we have put so many changes in place that have been the most aggressive changes that have ever been done at FHA in my professional history to try to get FHA back on the right track. And it is broad and far-reaching and has budget impacts.

I do believe there are many flaws in this particular study. And not only do I, but we have had it reviewed by a variety of other academics who feel the same way. But I don't want to understate the fact that what this study does, as well as many others, is it points out that given the variables in the FHA portfolio, there are concerns to be had.

Now, I just believe this study has some very unique flaws to it.

Mr. GARRETT. Let me get to the other point—I only have about a minute left—and that is with the downpayment requirements, initially, when I proposed legislation to raise those downpayment requirements, the pushback I heard from the Administration was there is basically no correlation, it is not necessary to do that. We can make some of these other adjustments in other areas prior to your tenure here, perhaps.

And now I am glad to see that there is some admission that there is some degree of correlation here, and you are going to look at it with low FICO scores with higher downpayment requirements. So that is the first step in the direction of saying that there is a correlation between default rates and downpayment requirements.

The question then is: Have we gone far enough in that regard that—we know the FICO score is something that can be manipulated. All you have to do is turn on the TV and you will see people say how to improve your scores and what have you. So that is not a true figure and an accurate 100 percent barometer in all sense.

So is there potential to move even further in this direction towards a consistent level of downpayment requirements in light of the fact that FICO is just one variable?

Mr. STEVENS. Yes. And Congressman—

Mr. GARRETT. Can you answer that? Just answer that in the next 10 seconds?

Chairwoman WATERS. Yes. You may take a minute to answer.

Mr. STEVENS. The answer is we are absolutely open, and believe that risk controls need to be in place appropriately. And we have taken the most aggressive steps to get responsible borrowers only approved in the FHA portfolio. And that has concerns a variety of participants in the industry.

Would we consider going further? We absolutely would consider anything necessary to get the FHA portfolio on the right track. I actually would say to your—the 5 percent proposal, I mean, that is why we went further and went to 10 percent. But we do know that FICO has a relationship.

I would love the opportunity to come in and meet with you and your staff. I recently met with many of the staff of the—

Mr. GARRETT. Right.

Mr. STEVENS. —Republican members on the committee, and I am—our team would love to come in and talk through the data with you because we believe that it is very important to have the responsible decision-making needed to keep this FHA portfolio on track.

Mr. GARRETT. Okay. Great. I appreciate it, and look forward to it. Thanks a lot.

Chairwoman WATERS. Thank you very much, Mr. Stevens. Thank you very much. We appreciate your being here today. The Chair notes that some members may have additional questions for this witness 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 Mr. Stevens and to place his responses in the record.

This panel is now dismissed. I thank you very much for being here, and I would like to welcome our second panel. Thank you.

I am pleased to welcome our distinguished second panel. Our first witness will be Mr. Mike Anderson, vice chair of government affairs, National Association of Mortgage Brokers and president, Essential Mortgage.

Our second witness will be Ms. Graciela Aponte, legislative analyst, Wealth-Building Policy Project, National Council of La Raza.

Our third witness will be Mr. Andrew Caplin, professor of economics, co-director of the Center for Experimental Social Science, New York University.

Our fourth witness will be Mr. John A. Courson, president and CEO, Mortgage Bankers Association.

Our fifth witness will be Mr. Charles McMillan, president, National Association of Realtors.

Our sixth witness will be Mr. John Taylor, president and CEO, National Community Reinvestment Coalition.

And our seventh witness will be Mr. Mark Alston, first vice president, Consolidated Board of Realtists, on behalf of the National Association of Real Estate Brokers.

I thank all of you for appearing today. I am especially appreciative—Mr. Alston, I know that the Realtors just had a convention. You just left. But you graciously decided to come back, and we are very appreciative of that.

Without objection, your written statements will be made a part of the record. And we will start with our first witness, who will be recognized for 5 minutes, Mr. Mike Anderson.

STATEMENT OF MIKE ANDERSON, CRMS, PRESIDENT, ESSENTIAL MORTGAGE, AND VICE CHAIRMAN OF GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Mr. ANDERSON. Good afternoon, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. I am Mike Anderson, a certified residential mortgage specialist, and vice chairman of the government affairs committee for the National Association of Mortgage Brokers.

In addition to serving NAM as a volunteer member, I am a licensed mortgage broker in the State of Louisiana, home of the New Orleans Saints, Super Bowl champions—had to throw that in—and I have over 31 years of experience.

I would like to thank you for this opportunity to testify today on the changes being proposed by FHA. My written testimony addresses the full range of policy changes happening at FHA, but I will focus my remarks this afternoon on just a few of the specific changes proposed.

I would like to thank Commissioner Stevens for his dedicated efforts to strengthen and protect the FHA loan program and the FHA insurance fund. NAM applauds his efforts and looks forward to working with the Commissioner going forward.

However, we are worried that there could be unintended consequences, and we believe there might be better approaches to certain aspects of the policy changes proposed in the FHA Reform Act. NAM hopes to work with HUD and this committee to attempt to resolve some of these issues.

First, we would like to work with HUD and this committee on the increased mortgage insurance annual premium fees of 1.55 percent. NAM believes a blanket increase, like the one proposed in the Reform Act, may stifle the housing recovery and could increase foreclosures even further by depleting the available pool of home buyers.

The MIP increase unnecessarily targets all buyers in every area of the country. The increase will lead to increased payments and reduce qualified borrowers We are particularly concerned that low-income and minority home buyers will be most negatively impacted.

NAM proposes that the FHA institute fee increases, if at all, based on actual risk posed by areas of the country that have high levels of defaults and experience substantial declines in home values. Why should the housing markets that restrained themselves

during the boom years have to pay for the irrational exuberance of those who did not?

Another issue that NAM would like to work on is the appraisal ordering. We believe that an FHA appraisal ordering system should be put into place to guarantee complete portability of appraisals so that consumers can save money.

NAM has advocated for many years for the removal of the unnecessary audit and net worth requirements for mortgage brokers' participation in the FHA program, provided that brokers are safe and compliant. Legislation introduced last Congress by Representative Miller and cosponsored by Representatives Sherman and Baca required such changes that are now being advocated by the FHA.

However, NAM believes it is important for loan correspondents to maintain some status with HUD and with FHA, and to regain access to the FHA system. Specifically, NAM believes loan correspondents must be able to obtain case numbers for FHA loans and communicate directly with FHA. Inability to communicate with the FHA or access FHA Web sites will make it virtually impossible to determine whether a borrower is even eligible for FHA financing.

Finally, NAM supports statutory changes to the permanent increase to the FHA conforming loan limits so that all consumers can benefit from the program, including those in high-cost areas such as California. Too often, in the wake of our current financial crisis, we have seen new rules promulgated that do not reflect measured, balanced, and effective solutions to the problems facing consumers and our markets.

NAM commends HUD for its work to strengthen and protect the FHA program. But we believe there is still work to be done in order to avoid some of the same pitfalls and unintended consequences that have resulted from other recent policy changes.

NAM appreciates the opportunity to appear before this committee, and we look forward to continuing to work with you and with HUD to craft solutions that are effective in helping consumers but do not unreasonably disrupt the market or competition.

And I would just like to make it clear that if these proposed changes are what it is going to take to fix FHA, we are willing to work with everybody involved. Thank you.

[The prepared statement of Mr. Anderson can be found on page 50 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Aponte?

STATEMENT OF GRACIELA APONTE, LEGISLATIVE ANALYST, WEALTH-BUILDING POLICY PROJECT, NATIONAL COUNCIL OF LA RAZA

Ms. APONTE. Good afternoon. My name is Graciela Aponte. I handle NCLR's legislative and advocacy work on issues critical to building financial security in Latino communities. For more than 7 years, I have been working on issues that impact low-income communities, and prior to joining NCLR, I worked as a bilingual housing counselor.

NCLR is the largest national Hispanic civil rights and advocacy organization in the United States. Last year, our network of HUD-

approved counseling agencies served more than 50,000 families. I would like to thank Chairwoman Waters and Ranking Member Capito for inviting us to share our views on this important topic.

In my testimony today, I will discuss changes proposed in the FHA Reform Act of 2010. I will also provide recommendations on how to further strengthen the FHA program. Overall, FHA stands out as a major success of the Administration's recovery efforts.

My comments today will focus on three questions that we use to evaluate the bill. Number one: Does it create new barriers for Latino home buyers? Number two: Does it protect FHA borrowers against predatory lenders? Number three: Will it promote sustainable homeownership?

On the first question, we found that the legislative changes will not likely create new barriers to affordable credit for modest income Latino families. However, more must be done. For example, FHA did not address the issue of expanding homeownership opportunities to underserved communities.

Measures that would address this concern include more flexible lending products, increased efficiency in underwriting, and incentives for borrowers who seek pre-purchase counseling. For example, NHN counselors are reporting difficulty securing mortgages for borrowers who use nontraditional credit, including timely rent payments, utility, and other payments.

Counselors also report that the FHA underwriting process is taking too long, affecting home buyers' chances of purchasing REO and short-sale properties. These inefficiencies allow investors, instead of first-time home buyers, to snatch up properties.

Also, NCLR is disappointed that FHA did not take this opportunity to create an incentive to encourage pre-purchase counseling for first-time home buyers. Counselors play a key role in preparing families for homeownership. Families who participate in counseling are less likely to default on their mortgage. Clearly, this would have the added benefit of preventing foreclosures and future claims.

On the second question, we recognize that some steps have been taken to protect home buyers. However, FHA needs to do more in this area. For example, in an initial review of FHA's Neighborhood Watch early warning system, the online tool was not user-friendly.

We hope to work with HUD to improve this site, including a portal for the public to submit and view complaints. The true test will come over time when HUD demonstrates its willingness to enforce its own provisions.

On the third question of sustainable homeownership, FHA did not take any steps to boost foreclosure prevention efforts to help stabilize communities. FHA has strong loss mitigation tools that have successfully kept millions of families in their home. However, these services are of little use to a family who does not receive them.

While HUD mandates that FHA servicers aggressively pursue loss mitigation, few resources are dedicated to enforcing this provision. In a recent survey, we found that 76 percent of housing counselors rate the knowledge of lenders of FHA loss mitigation tools as fair or poor.

Ultimately, NCLR supports the changes proposed in the FHA Reform Act of 2010 to provide future financial stability to the program. However, a reinvigorated and assertive FHA program is critical to stabilizing the housing market and the broader economy.

In that spirit, NCLR makes the following recommendations to strengthen the FHA program, restore homeownership opportunities, and protect homeowners and taxpayers: increase transparency and enforcement in FHA lending; provide incentives to borrowers who seek homeownership counseling; increase access to flexible lending models; make loss mitigation accessible to all FHA borrowers, and enforce its proper implementation by servicers; and increase funding for HUD-approved housing counseling agencies.

In my written testimony, you will find specific details about each of these recommendations. I will be happy to answer any questions. Thank you.

[The prepared statement of Ms. Aponte can be found on page 62 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Caplin?

STATEMENT OF ANDREW CAPLIN, PROFESSOR OF ECONOMICS, CO-DIRECTOR, THE CENTER FOR EXPERIMENTAL SOCIAL SCIENCE, NEW YORK UNIVERSITY

Mr. CAPLIN. Chairwoman Waters, and Ranking Member Capito, I am honored that you invited me to this hearing. The Federal Housing Authority, which has for so long done wonderful work to support housing affordability, is currently being placed at risk.

The limitations of FHA data infrastructure, which are of long standing, have in the current environment raised risk to an undesirable and perhaps unsustainable level. Therefore, with all due respect, I cannot agree with Commissioner Stevens' view that it would take a catastrophic fall in house prices for FHA to require a taxpayer-funded bailout.

Recent research indicates that the actuarial review on which the Commissioner relied in making his assessment understates FHA risk, while we do not have access to the data needed to gauge the full extent of this understatement. While we are here to discuss proposed FHA reforms, I am here to caution you that the impact of these reforms on a mutual mortgage insurance fund is impossible to assess.

The problems in the actuarial review first came to my attention when Joseph Tracy, who is vice president and senior advisor to the president of the Federal Reserve Bank of New York, noticed that FHA prepayment behavior changed radically in 2009. Many mortgages that were significantly underwater suddenly started to prepay at an unprecedented rate. It is as if a group of particularly sick patients at a hospital suddenly appeared cured.

As is so often the case, if it seems too good to be true, it is. Joe and I were able to discover the cause of this apparent miracle cure, which turns out to be poor recordkeeping when one FHA mortgage is streamline refinanced into another.

To use the hospital analogy, very sick patients were moved to a new ward for treatment, yet were recorded as having been cured and discharged from the hospital. They were then logged into the

new ward as if they were relatively healthy new patients without new intake measurements and without reference to their prior history.

The more this hospital moved patients between wards, the higher its apparent success rate. Unfortunately, FHA did the equivalent in its recordkeeping, as a result, overestimating its success rate.

The actuarial review has other shortcomings detailed in our joint research. For example, it analyzes only final claims to the FHA's mutual mortgage insurance fund, and ignores delinquency rates. It also ignores mortgage modifications, which are increasingly prevalent, costly, and of unknown efficacy. This is like tracking a disease by monitoring mortality rates while ignoring information on rates of initial infection, hospitalization, and post-intervention outcomes.

It is hardly surprising, then, that the most recent actuarial review began by listing reasons that the prior review had underestimated losses. There is every reason to expect this pattern to recur.

Three proposals by way of conclusion.

One: FHA must immediately update its risk assessment and its risk assessment methodology. Until this is done, it will be impossible to assess the impact of FHA reform proposals on FHA risk.

Two: FHA appears unable at this stage to assess the quality of its actuarial review. It must open its books to outside analyses to upgrade its risk assessment.

Three: Some 12 years ago, Joe Tracy and I helped co-author a book called, "Housing Partnerships: A New Approach to a Market at a Crossroads." We proposed introducing equity capital into the real estate finance equation to encourage risk-sharing.

Unfortunately, the opposite path was taken, and recent investigations in housing finance instead acted to increase leverage and to amplify risk. It is time to go back to the fork in the road.

Dating back to the Great Depression, the U.S. Federal Government has a positive track record of encouraging innovation in housing finance. Now is the perfect time to reinvigorate that tradition by ceding development of equity finance as a far safer method of raising housing affordability.

[The prepared statement of Professor Caplin can be found on page 70 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Courson?

STATEMENT OF JOHN A. COURSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION

Mr. COURSON. Thank you very much, Madam Chairwoman, and Ranking Member Capito. I appear before you today not only as the president and CEO of the Mortgage Bankers Association, but also as a former chair of MBA and an FHA lender for over 40 years. MBA is pleased to see the attention that the Financial Services Committee, and this subcommittee in particular, continues to play to the Federal Housing Administration, its programs, and its finances.

Today, FHA finds itself at a critical crossroads. Last November's actuarial report was a wakeup call to us all, and it highlighted the very real threats to FHA's continued solvency.

All of us here today support FHA and the important role it plays in promoting homeownership. However, that role could be greatly diminished, even disappear, if we don't get FHA's fiscal house in order.

HUD Secretary Donovan and FHA Commissioner Stevens should be commended for the proactive steps they have taken to protect the mutual mortgage insurance fund. They have made improvements to FHA's appraisal procedures, its streamlined refinance program, the process for approving lenders, and they have kept in place the prior Administration's ban on seller-funded downpayment assistance.

More recently, the Obama Administration put forward a package of reforms, some of which are being implemented administratively while others require legislative action. I would like to comment on these changes from the perspective of MBA's very diverse membership.

First, MBA supports HUD's proposal to increase the cap on the annual mortgage insurance premium for FHA's single-family program. Raising premiums is never desirable, but if done prudently and if coupled with decreases in the up-front MIP, this step has the potential to strengthen FHA's books while actually lowering closing costs for many borrowers.

HUD also proposes to expand and extend indemnification requirements for all FHA salary lenders. The initial reaction from our members has been largely positive, but we would also urge great care in how this change is implemented.

Lenders take indemnification very seriously. If lenders fear unreasonable standards or penalties, they could become overly cautious. The details of any proposal in this area will be critical, and we urge the subcommittee to move carefully to ensure that responsible lenders are not discouraged from participating in the FHA program.

The third legislative change sought by the Administration would give FHA authority to suspend a lender nationwide on the basis of the performance of one of its regional branches. We all support rooting out fraudulent lenders. They hurt borrowers, put the MMI fund at risk, and they are a stain on our entire industry.

At the same time, suspending a lender is a very serious action and should be undertaken cautiously and only when justified. MBA urges this subcommittee to ensure that this policy allows lenders ample opportunity to remediate any problems within a field office before receiving a nationwide sanction. These policy changes should be clear, transparent, and apply to all lenders.

I want also to comment briefly on some of the non-legislative changes proposed by FHA. MBA supports increasing the downpayment to 10 percent for FHA's riskiest loans, loans where a borrower has a credit score below 580. However, we would caution policymakers to resist imposing an across-the-board increase in the FHA downpayment, as this would have a chilling effect on the ability of FHA to meet the credit needs of the very borrowers it is intended to serve.

MBA is also concerned about the 50 percent reduction in the maximum seller concessions, which are typically used to cover closing costs. This change will primarily impact low- to moderate-in-

come first-time and minority home buyers, the very populations FHA is designed to serve.

One step FHA has yet to take, but should take, is to examine its total scorecard underwriting system. Such an evaluation should review the thoroughness of the scorecard's borrower risk assessment capabilities.

Finally, I can't stress enough the importance of ensuring that FHA receives adequate funding for upgrading its antiquated technology and hiring additional staff for both its single-family and multi-family programs. The House has already passed H.R. 3146, the 21st Century FHA Housing Act. And with appropriation season just around the corner, we need to redouble our efforts to make sure FHA gets the needed funding appropriated.

Madam Chairwoman, Ranking Member Capito, there is no sugarcoating the unsafe position in which FHA finds itself today. We simply must take the strong and necessary steps to protect its vital programs, the MMI fund and, ultimately, the taxpayers who stand behind it.

MBA stands ready to work with you, Secretary Donovan, and Commissioner Stevens in this important endeavor. Thank you.

[The prepared statement of Mr. Courson can be found on page 78 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. McMillan?

STATEMENT OF CHARLES McMILLAN, CIPS, GRI, IMMEDIATE PAST PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. MCMILLAN. Thank you, Madam Chairwoman.

Chairwoman WATERS. I am sorry, I pronounced your name incorrectly. How do you pronounce your name again?

Mr. MCMILLAN. My name?

Chairwoman WATERS. Yes.

Mr. MCMILLAN. "McMillan."

Chairwoman WATERS. Oh, okay. Thank you.

Mr. MCMILLAN. You pronounced it correctly.

Chairwoman WATERS. Thank you.

Mr. MCMILLAN. And thank you, Madam Chairwoman, Ranking Member Capito, and members of the subcommittee. I am Charles McMillan, the immediate past president of the National Association of Realtors. I thank you for your invitation to give testimony today.

I have been a Realtor for more than 25 years, and am director of Realtor relations and broker of record for Coldwell Banker Residential Brokerage in Dallas/Fort Worth. I am here to testify on behalf of 1.2 million members of the National Association of Realtors on the importance of the Federal Housing Administration mortgage insurance program.

Since it was created in 1934, FHA has provided more than 37 million American homeowners with safe, stable financing in all markets. And while the program is experiencing shortfalls in its excess reserves due to our economic crisis, FHA remains financially strong, in our opinion, and is critical to our economic recovery.

In 2009, FHA insured nearly 30 percent of the single-family mortgage market. In 2009, more than 50 percent of first-time buy-

ers used FHA. And during the same time, approximately 835,000 borrowers refinanced into lower interest rate FHA-insured loans, saving an estimated $1.3 billion.

Historically, FHA's market share has hovered between 10 and 15 percent of the market. When the private market is strong enough to return, we welcome a reduction in FHA's market share. However, in the meantime, we support FHA's efforts to fill the gap that private lenders have left.

We have testified previously about the reasons that the FHA audit showed they had fallen below the 2 percent capitalization ration, and I won't repeat that information except to say that we believe FHA has continued to require prudent understanding, and has sufficient controls against risk. Today, I will focus my remarks on FHA's new initiatives and what Congress can do to help strengthen this important program.

First, FHA has increased the up-front mortgage insurance premium from 1.75 percent to 2.25 percent. Home buyers are already facing increased fees from appraisal and other closing services. Increasing the up-front premium for FHA loans just adds to the problem.

We support legislation to reasonably increase the annual premium in order to replace FHA's capital reserves. However, we believe FHA should then decrease the up-front premium to help borrowers at the closing table.

Second, we understand that FHA intends to propose a rule to decrease seller concessions to 3 percent. In States where closing costs are high, like my own State of Texas, seller concessions are often higher than 3 percent.

Such concessions help many borrowers with closing costs, allowing them to purchase a home without depleting all of their savings, and, I might add, allow many borrowers the first and almost only opportunity to get one foot on the bottom rung of the housing homeownership ladder. Again, we are concerned that such a decrease in concessions could put homeownership out of reach for many buyers.

Third, FHA has proposed that borrowers with a credit score below 580 be required to have at least a 10 percent downpayment. NAR does not believe FHA should make loans to borrowers who are unable to repay. However, we are concerned about the disparate impact that credit scores have on underserved buyers.

Other ways Congress can help strengthen FHA: We strongly support H.R. 2483, the Increasing Homeownership Opportunities Act. This bill would make the current loan limits permanent, and we urge the committee to quickly consider this.

Second, we strongly oppose H.R. 3706, the FHA Taxpayer Protection Act of 2009. This bill would increase FHA's downpayment, and again have the aforementioned action. NAR believes in the importance of the FHA mortgage insurance program. With solid underwriting requirements and responsible lending practices, the FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry.

We urge the Administration and Congress to move cautiously before making these changes. I thank you again for the privilege of

providing this testimony, and of course would be willing to answer any questions.

[The prepared statement of Mr. McMillan can be found on page 86 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. John Taylor, I understand that you are having your conference here this week, and I hope everything is going well.

Mr. TAYLOR. Everything is going very well.

Chairwoman WATERS. We welcome you on the panel today.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Thank you, Chairwoman Waters, and thank you, Ranking Member Capito, for the opportunity to testify today. My name is John Taylor, and I am the president and CEO of the National Community Reinvestment Coalition.

We are an association of some 600 community organizations spread out across America whose primary job is to try to increase fair and affordable banking services, banking products, investments, great affordable housing, job development, and overall to promote vital communities across the country.

And I, too, agree with the notion that FHA has been one of the Obama Administration's success stories. I had some doubts about Mr. Stevens when I first met him, but any of those have pretty much dissipated.

His work around appraisal procedures, the LMI fund, rooting out in particular frauds and scams and really going after some of the folks who really give the industry a bad name in general, has been pretty impressive.

And what is ironic is normally I am here at these hearings coming up to criticize FHA for either discriminatory lending practices or for what it is not doing in LMI areas. And I have to say, I think this Administration and this Commissioner are quite committed to trying to be very effective on that score.

In fact, the truth of the matter is, and anybody who is paying attention knows this, if it wasn't for FHA, we probably wouldn't have any lending going on in America's low-income communities.

So hopefully, though, I would love to see—and I think Commissioner Stevens supports this—the day when they begin to reduce the size of their portfolio and get the private sector back in there.

Because while FHA is better than subprime, they are not as good as prime. There is a premium that folks who go through FHA pay. It is about 3/4 of a basis point difference. And it is the cost that people are going to pay to be part of that program. But nonetheless, I think what they have put in in the way of safeguards throughout this program is something that is in fact helping many people across the country.

Let me say that we support FHA's proposals relating to adjustments to the annual and up-front premiums. We support their combination of FICO scores and downpayment requirements. And I can talk about all these in more detail if there is a desire to, but it is in my written testimony.

We support the reduction of allowable seller concessions, and we support the discussion draft language of the FHA Reform Act to allow HUD to require that all FHA lenders, not only those with permission to approve loans without pre-endorsement review, but that all lenders reimburse HUD for fraud and misrepresentation.

In addition, HUD should have additional authority under the Credit Watch initiative to shut down lender operations in geographic areas of various sizes, as well as shutting down the entire FHA operations of a lender. These proposals, I think, would increase safety and soundness and shore-up the secondary reserves of FHA.

But we also have a couple of recommendations. First, similar to my friend Graciela Aponte from La Raza, we think that you need to increase the role of the nonprofit counseling agencies. NCRC understands that HUD has the authority to reduce the up-front premium if the borrower receives counseling from a HUD-approved counselor.

HUD, however, does not have the authority to reduce the annual premium amounts if a borrower has counseling. NCRC recommends that Congress grant HUD this authority since counseling has proven to be effective, and since reductions in premium amounts will assist in increasing the affordability of FHA loans for those borrowers receiving counseling.

NCRC also recommends bolstering fair lending enforcement. FHA has played an important role in preserving access to credit in this difficult economic environment, yet evidence suggests that when controlling for lender, borrower, the neighborhood characteristics, communities of color received a disproportionate amount of FHA loans. And as I said, those are simply just more expensive than the prime market.

Increasing the fair lending enforcement would promote more competition among lenders and lower prices by prosecuting redlining by traditional lenders and any targeting of communities by FHA lenders.

HUD and the Federal banking agencies should consider the use of match paired testers in its enforcement efforts. The testing could be conducted by a nonprofit organization with civil rights enforcement expertise.

Just a brief comment about HAMP, and that is FHA has a sensible and affordable HAMP program, but NCRC's counselors report that it is not being used by lenders at a meaningful level. HUD and Treasury should encourage lender use of FHA HAMP.

In closing, FHA was created in 1934 to heal the U.S. market during the Great Depression. And for decades, it has turned a profit for taxpayers. Today, it is more critical than ever that FHA remain a strong gateway for responsible underwritten credit in communities where they serve.

Thank you very much for the opportunity.

[The prepared statement of Mr. Taylor can be found on page 113 of the appendix.]

Chairwoman WATERS. You are welcome.

Mr. Mark Alston.

STATEMENT OF MARK ALSTON, FIRST VICE PRESIDENT, CONSOLIDATED BOARD OF REALTISTS, ON BEHALF OF THE NATIONAL ASSOCIATION OF REAL ESTATE BROKERS

Mr. ALSTON. Thank you, Chairwoman Waters, and Ranking Member Capito. My name is Mark Alston. This testimony is to present the National Association of Real Estate Brokers' position with regard to the proposed changes.

My testimony is going to be presented from the loan originator, the point of sale originator, mortgage professional, and consumer point of view. My background has always been in residential real estate, mostly in what has been considered underserved neighborhoods. I have over 22 years of experience.

The first change we would like to address is the downpayment and FICO changes. It is our position that these changes will help create sustainable homeownership. A 580 FICO score falls well below the threshold that most of the lenders that we deal with will approve. For most lenders that we deal with, it is 620 to 640. A 580 score is a good threshold for responsible homeownership; 500 to 579, with 10 percent down, that offsets the risk. I don't know anybody who will approve it, but we support these changes if it is there.

What is concerning to us are today's tendencies for these guidelines not to be administered and designed as designed by funding institutions. Almost unanimously, institutions impose stricter underwriting overlays that exceed FHA guidelines, and exclude families for whom these programs were designed.

With regard to the next change, the increase in the annual mortgage insurance premiums, we have serious concerns. This change—keeping in mind the requirement for FHA to maintain a 2 percent reserve, and we want to be mindful of the decisions that are made and their impact at the consumer level. We are not sure that what may need to be addressed is the amount of the reserve or how it is calculated.

I was instrumental in the design and implementation of a Fannie Mae pilot program designed to reduce the disparity between minority ownership and majority ownership in 2001. At the time, majority ownership was around 78 percent; minority ownership was around 44 to 48 percent.

One of the principal players in this program, this pilot program with Fannie Mae, were the mortgage insurance companies, the PMI companies. What ended a great program was when they raised their annual MMI or PMI.

When it went to 1.5 and higher, it priced people out of the market and opened up the door for the subprime market. It became cheaper to go 80/20, and so a lot of people went that way.

FHA is expensive. I have heard it said that FHA wants to be in a more competitive position with the private companies. The private companies have the monthly insurance. They don't have the up-front as well as the monthly insurance.

When you have someone—I have sat with clients. You are trying to explain to them what their payment is going to be. You have a $200,000 sale. They put $7,000 down. They have a $193,000 balance, or so they think. With FHA, their balance is actually going to be closer to $198,000. It is going to be $4,500 more for mortgage

insurance. Then you go through the payment, and you have another mortgage insurance premium. They are paying twice. FHA is just really expensive at the consumer level.

In increasing the annual fee from .55 today, on a $250,000 house, that amount would be $110.57. If they raise it to .85 percent, the amount of the monthly payment for mortgage insurance will go to $179.80. They go to 1.55 percent, it goes to $311.61, or $201 more than the .55 amount.

One of the hardest things we do in our area is to qualify borrowers. Our ratios are already high. We are not operating at the 29 over 41 percent guidelines. Our housing load is more like 45, 46, 47 percent to get people in, even though prices have dropped by half. Our average price was 580; now it is 250, 260. It is still tough for people to qualify.

In addition to FHA, the GSEs have been the largest source of mortgage capital for minority home buyers in the country. While Fannie Mae and Freddie Mac have faced significant losses in recent years and have required a significant infusion of taxpayer dollars, these institutions' critical role for minority home buyers cannot be underestimated.

However, in order to keep homeownership affordable, we urge Fannie Mae to rescind their adverse market delivery charge, as well as the series of loan level price adjustments; and Freddie Mac to rescind their post-settlement delivery fees, as well as market condition and indication score loan-to-value pricing adjustments. The former fee—

Chairwoman WATERS. Could you wrap it up, please?

Mr. ALSTON. Yes. We at NAREB are extremely concerned by any change that will significantly impact the cost of homeownership, while at the same time we recognize the importance of having FHA to serve our home buying community. We appreciate the opportunity.

[The prepared statement of Mr. Alston can be found on page 40 of the appendix.]

Chairwoman WATERS. Thank you very much.

I would like to share with this panel that I am very appreciative for your testimony here today. What I am gleaning from your testimony is that everybody would like to have a sound and stable FHA performing in the way that it was intended to perform, and making opportunities available for low- to moderate-income home buyers. Everybody agrees on that.

Some of you agree with all of the changes that are proposed, some agree with some of the changes that have been proposed, and some have additional advice about what should be done to make all of this work.

I am very appreciative that the Secretary appears to be open, and it is important for us to get our information in during the comment period so that we can help to guide FHA in its attempt to comply with the law, to be safe and sound, and to have the capital requirements that are mandated by law.

I want to ask just a few questions. One is on the requirements for the lenders. I heard some discussion about that today, that the requirements for capital for lenders is too low, that it should be increased. But it appears that the increase is too much.

Who would like to respond to that? Yes, sir?

Mr. COURSON. I would be more than happy to respond on behalf of the Mortgage Bankers Association. Obviously, we have put together a task force, and our membership is very diverse. We have really from the largest of the large financial institutions to the very smallest, as the Congressman was saying earlier, the very small local mortgage originators.

And through this group and a lot of discussion, we came out and we do support the increase of the net worth to $2.5 million, but—and we have commented back to the Department—that we feel like there needs to be an extended period of time for lenders and mortgagees to be able to increase that net worth.

Our comment was that over—and our analysis by this diverse group was that over a period of 5 years, even the small members would be able to grow into that $2.5 million. And the reality is, Madam Chairwoman, that today, with the markets, without those kinds of net worth, those lenders are not going to be able to get warehouse lines or financing to fund loans, in any event.

But we are asking and commented that we would like a longer period of up to 5 years to earn their way into the $2.5 million.

Chairwoman WATERS. I appreciate that. I must admit I am a little bit worried about this. I know that many of these small loan initiators are much smaller than $2.5 million. I suppose there is some amount that is too small.

But to jump from, what is it now, $250,000? What is it now? What are—

Mr. COURSON. Currently, to be a mortgagee, it is $250,000. To be able—a direct endorsement and underwrite FHA loans, it is a million dollars.

Chairwoman WATERS. Okay. To jump to $2.5 million.

Mr. Alston, how does that play down in southern California?

Mr. ALSTON. For our neighborhood, for my neighborhood, it is tough. There are a couple of proposals on the table. One is to eliminate the mini, which allows brokers to—where HUD approves brokers, allow them to operate as Fannie Mae and Freddie Mac with lenders.

If you increase that capital requirement, you get rid of a lot of the small players. We don't have the capital to qualify. And so we'll have to just be brokers, small warehouse lines or being direct lenders and being able to open that way. We won't be able to do it.

Chairwoman WATERS. Ms. Aponte, how would this impact the constituency that you represent?

Ms. APONTE. Well, what we are hearing from our counselors specifically, the issues that they are facing, is mostly the efficiency in FHA underwriting. They are trying to purchase REO properties. They are trying to purchase short sales. They are taking more and more time to access credit for those products.

Chairwoman WATERS. What about the capital requirements for loan initiators?

Ms. APONTE. I would have to get back to you on that. I am not sure.

Chairwoman WATERS. Anybody else on this issue? Yes, Mr. Taylor?

Mr. TAYLOR. You know, in this day and age of everybody has to have skin in the game, I think they should as well. And particularly where we have seen this proliferation of scams and fraud, if you go after somebody and they have absolutely no net worth, they don't have value whatsoever, the government cannot recoup in the event that they have created costs and created harm.

So I think it is important to have some level of skin in the game. What that would be, you could probably debate that for a while. But I think that it has to be significant enough for them to be something other than, you know, a fly-by-night where you can just print up some papers, call yourself a broker, get a license as easy as you get—brokers are not going to like this—a membership at the Y, and then start doing FHA loans.

I think we need to have a little bit more professionalism and skin in the game, so to speak.

Chairwoman WATERS. So do you think the proposal to spread it out over a 5-year period of time would help those who are serious about being loan initiators to try and achieve that level of capital in order to participate? Anybody? Does that help? We had that suggestion.

Yes, Mr. McMillan?

Mr. MCMILLAN. I would offer an opinion, yes, because as I sit here and listen to the testimony, there must be balance. As Mr. Taylor said, you will have fly-by-night people with minimum capitalization, they get censured, they move away.

But it also has a tendency to disenfranchise many principled lenders that serve underserved neighborhoods, and the 5-year grace period would give them an opportunity to come up with it as opposed to shutting them out of the system.

Chairwoman WATERS. All right. Thank you very much.

Ms. Capito?

Mrs. CAPITO. I thank all the witnesses. And first of all, I would just like to make a statement on one of the recurring issues that we have heard in the subcommittee and several of you alluded to in your testimony, and that is the lack of technology and computer expertise at FHA and at HUD in general.

In this day and age, that should not be a reason that we are not delivering the product, getting the information, or being able to work expediently. And we have worked together to try to make sure that FHA has the dollars and the manpower to be able to move forward, and HUD at the same time. So we will keep trying to work on that.

Mr. Caplin, in your testimony, you basically were raising some major red flags as to the actuarial review of FHA, some of the data points that have been brought forward. Now, you know that FHA—and he was here earlier today with the administrators—hired a risk management officer.

I am wondering if the studies that you did were before they have—no, it was after the risk management officer has been—could you speak to that in terms of how you think that is going to help the process, if at all?

Mr. CAPLIN. Right now, my image is that they simply are caught unawares by the changes in the marketplace. So what happened is

there was a major switch in termination behavior of the loans. They didn't catch it the first time around.

That is—in a way, I don't know where to hand responsibility. It might be IFE. It might be that the people reading from FHA should have picked that up. It seems that it is endemic that nobody quite has enough data on hand, or enough of it gathered together, to be able to answer the questions in the correct way.

That persists today. Now, I don't blame those who have just come in.

Mrs. CAPITO. Right.

Mr. CAPLIN. That is, they really are new. But I do believe that the right response is, oh, some problems have been identified. These are genuine problems; they need to be rectified.

In the process of rectifying them, I believe one would uncover what the system needs to be for effective risk management in the future. And currently, it is just not in place.

Mrs. CAPITO. Do you think this, in part, is an explanation for the difference in the two figures that we were discussing earlier? I don't know if you were here for the first panel, but the two estimating figures, the White House and then the CBO, there is a vast difference between what the estimated revenues would be. I mean, it is like a $4 billion difference.

Is that playing into the same scenario that you are speaking about?

Mr. CAPLIN. That is just the beginning; it is much larger than that, if you go forward and simulate out with different models. The differences are massive.

Mrs. CAPITO. All right. Thank you.

Mr. Courson, we have talked a little bit about—and there have been some differing opinions on the proposal to go below 579 and increase the downpayment to 10 percent.

Are many of your members currently doing FHA loans with a FICO score of 579 and below?

Mr. COURSON. No, they are not, Congresswoman. And I would like to comment on that. We have talked a lot about FICO scores today, and the comment has been made that even at 580, there are not a lot of loans being made.

Underwriting—having been in this business for more than 40 years—is an art. It is not a science. And we keep talking about numbers, a 580 or a 620.

We have said, and we believe, that in addition to FICO score—which is an indicator—that what really needs to happen here to look at the credit and who is creditworthy is to look at the FHA's automated underwriting system, Total Scorecard, that they came out with a number of years ago.

But I find it interesting that through these hearings, we are not talking about looking inside their automated underwriting system and looking at what the indicators are in there. That is what lenders are using to make credit judgments. It is not just the FICO. There are a lot of factors that make a decision as to whether that loan is an appropriate loan to be made.

I have mentioned this to Commissioner Stevens, and we are going to be working with him, hopefully to get inside this under-

writing system for a more robust decision as opposed to just a FICO-based decision.

Mrs. CAPITO. Ms. Aponte, I am curious. We have had this in several other hearings, certainly with the foreclosure mitigation, different programs that we have dealt with. Millions and millions, probably billions, of dollars going to housing counseling.

Is your organization one of those nonprofits—and Mr. Taylor, I am sure you know many as well—that are getting either the stimulus dollars or other dollars? Can you quantify that for me, how much La Raza is presently getting this year for housing counseling?

Ms. APONTE. Sure. We are one of, I would say, about 15 or so. There are national HUD intermediaries.

Mrs. CAPITO. Right.

Ms. APONTE. So we do receive funding through HUD. And we also through the NFMC program, which is specifically for foreclosure prevention, I believe last year it was $1.3 million, and the highest amounts that folks were receiving were $3.5 million. So about five other organizations received that amount, and we are at about $1.3 million for the last year.

Mrs. CAPITO. Is the increase in that—do you think it is having any effect in terms of not the origination, maybe, so much, but keeping people in their homes? Are you finding some success with the housing counseling, since we are putting a lot of dollars into it?

Ms. APONTE. Yes. There are a lot of other factors that go into foreclosure prevention. So just because the MHA numbers are showing that loan modifications are difficult, there are a lot of trial period modifications. Counselors are able to help families with different options for foreclosure prevention.

There are short sales that—some people don't qualify for a loan modification. They need help to get a short sale. Some people will need to get a deed in lieu. Some people will go into foreclosure, but the counseling agency is there to help them—there are support groups that are developed through these community-based organizations—and to help them rebuild their credit and get back on their feet.

Mrs. CAPITO. Well, thank you. Just in closing, I would like to thank everybody, too. I think we have gotten a lot of good perspectives. And I would like to encourage you all to take a look at the bill I just dropped yesterday, and any input that you would care to give me and all of us, I would certainly appreciate it.

I think certainly the safety and soundness of FHA is extremely critical to many, many people across this country. And to you all and your businesses, certainly, but these are families in homes with futures. So thank you very much.

Chairwoman WATERS. I also would like to thank all of you for your participation here today. I have also learned an awful lot.

I really would like to encourage you to participate in the comment period, and to continue to talk with us. Call us. Meet with us. Meet with our staffs in our offices to further support your position as it relates to the changes that are being proposed by FHA.

And I would like to talk with some of you about the appraisal system and some complaints that I have had about consolidation

in that area and a few other things. So we are going to rely on you and your expertise to help us do it right. Thank you all very much.

The Chair notes again that some members may have additional questions. Yes, without objection, we have a communication from the Manufactured Housing Association for Regulatory Reform to be entered into the record.

Those are the only written statements that we have. I thank you, and this hearing is adjourned.

[Whereupon, at 4:04 p.m., the hearing was adjourned.]

A P P E N D I X

March 11, 2010

Testimony by Mark Alston
National Association of Real Estate Brokers

To: The Committee on Financial Services
U.S. House of Representatives Chairwoman Congresswoman Maxine Waters.

My name is Mark Alston, this testimony is to present the National Association of Real Estate Brokers position with regard to the proposed FHA changes.

The testimony will be presented from the point of sale originator and consumer points of view.

My background has always been in residential real estate, mostly in what has been considered underserved neighborhoods and minority communities. The first change we would like to address is the down payment and fico changes, it is our position that these changes will help to create sustainable Home Ownership.

We appreciate the role that FHA has played in bringing the American Dream of ownership to our communities while recognizing that the responsibility of ownership carries with it the responsibility of managing ones income and finances. Fico score (credit) implies the willingness to pay and is a predictor in loan performance. 580 as a minimum threshold for maximum mortgage financing is a generous threshold, also recognizing that risk is generally off-set by down payment or what has been referred to lately as, " skin in the game". Increased down payment for fico scores under 580 seems to be more than fair. We are in support of this proposed change.

What is concerning are today's tendencies for these guidelines not to be administered as designed by funding institutions. Almost unanimously institutions impose stricter underwriting overlays that exceed FHA guidelines and exclude families for whom these programs have been designed. With regard to the proposed changes in the annual mortgage insurance premium from .55% to a minimum of .85% with the authority to raise the annual premium to as much as 1.55% we have serious concerns.

Keeping in mind the requirement for FHA to maintain a 2% reserve, we want to be mindful of the decisions that are made and there impact at the consumer level. What may need to be addressed is the size of the reserve requirement.

I was instrumental in the design and implementation of a Fannie Mae pilot program designed to reduce the disparity between minority ownership and majority ownership in 2001. At the time majority ownership was 78%, while minority ownership hovered somewhere between 44 and 48%.

One of the principal players in this program were the private mortgage insurance companies. What ended what seemed to be a successful program was the increase in the mortgage insurance rates from .5% to well over 1.5%, we're concerned that could be the case again.

On a sale price of $ 250,000.00 at .55% the monthly premium would be $110.57 at that same sale price the monthly premium would be $170.89 at a rate of .85%, at the maximum rate at 1.55% the monthly premium would be $ 311.61 or $201.04 more than the .55% monthly premium. This is in addition to an increase in the upfront mortgage insurance premium of .5% from 1.75% to 2.25%. We believe the financial impact to borrowing families would be better absorbed by additional increase in the upfront MIP which is financed in most cases.

In addition to FHA, the GSEs had been the largest source of mortgage capital for minority homebuyers in the country. While Fannie Mae and Freddie Mac have faced significant losses in recent years and have required significant infusion of taxpayer's dollars, these institutions' critical role for minority homebuyers cannot be underestimated. However, in order to help keep homeownership affordable we urge FNMA (Fannie Mae) to rescind their Adverse Market Delivery Charge (AMDC) as well as the series of Loan Level Price Adjustments (LLPAs) and Freddie Mac to rescind their Post-Settlement Delivery Fees as well Market Condition and Indication Score/LTV pricing adjustment. The former fee adds an extra .25% to all loans without regard to risk characteristics, borrower credit or property value, and the latter vary based on a complicated and

cumulative matrix of factors. Both these fees will dramatically increase the cost of homeownership and thereby effectively pricing many borrowers, especially low- and moderate-income borrowers and racial and ethnic minorities out of the market.

In the current economic environment, foreclosures continue to peak and unemployment remains high. Thus, it is even harder for many people, especially moderate-income families and racial and ethnic minorities, to pursue the American dream of homeownership and be a part of our nation's economic recovery. Mortgage originations for these populations are currently at an all time low. As American family income and wealth continues to decline and access to credit and capital has tightened, now is not the time to introduce new borrower fees. While we understand that these fees are being levied in the name of risk management, it does not appear that any of the money generated by the new fees is being set aside to pay losses, to fund borrower rescue programs or in any way support housing or lessen the burden of taxpayers.

We at NARAB are extremely concerned by any change that would significantly impact the cost of home ownership while at the same time we recognize the importance of having an FHA to serve our home buying community.

Thank you for the opportunity

Sincerely,

Mark Alston
National Association of Real Estate Brokers

Impact Of GSE LLPAs - $150,000 Home, 95% Loan

FICO Score	Total LLPA % -a)	Total LLPA $	Borrower Note Rate Impact	Borrower Payment Impact	Affordable Home Impact	Loss of Affordability	Loss of Affordability %
>= 740	0.25%	$594	0.06%	$9	$248,820	$1,180	0.5%
720 - 739	0.25%	$594	0.06%	$9	$248,820	$1,180	0.5%
700 - 719	0.75%	$1,781	0.19%	$28	$246,570	$3,430	1.4%
680 - 699	1 1.00%	2 $2,375	3 0.25%	4 $37	5 $245,454	6 $4,546	7 1.8%
660 - 679	2.00%	$4,750	0.50%	$75	$241,058	$8,942	3.6%
640 - 659	2.50%	$5,938	0.63%	$93	$238,898	$11,102	4.4%
620 - 639	3.00%	$7,125	0.75%	$112	$236,765	$13,235	5.3%

Assumptions:

Base Note Rate:	5.25%
Home Price	$250,000
Loan-To-Value %	95%
Loan Amount	$237,500
HDTI Ratio	31%

Example 95% LTV Loan to a FICO 680 borrower:

1. GSE delivery fees sum to 100 basis points, or $2,375 on the $237,500 loan amount
2. Lender must charge as points to borrower (additional cash at closing) or "premium price" into note rate
3. Estimated amount of note rate increase required to generate 100 basis points of additional loan price is 25 basis points
4. Monthly payment increase created by the additional note rate is $112
5. Borrower who could have afforded a $250,000 home now limited to $245,454 due to LLPA fees.
6. Loss of affordability due to LLPA fees.
7. Loss of affordability due to LLPA fees, expressed as a percent of $250,000 original home price

Impact Of GSE LLPAs - $250,000 Home, 95% Loan

FICO Score	Total LLPA % -a)	Total LLPA $	Borrower Note Rate Impact	Borrower Payment Impact
>= 740	0.25%	$594	0.06%	$9
720 - 739	0.25%	$594	0.06%	$9
700 - 719	0.75%	$1,781	0.19%	$28
680 - 699	1.00%	$2,375	0.25%	$37
660 - 679	2.00%	$4,750	0.50%	$75
640 - 659	2.50%	$5,938	0.63%	$93
620 - 639	1 3.00%	2 $7,125	3 0.75%	4 $112
< 620	3.25%	$7,719	0.81%	$122

Assumptions:

Base Note Rate:	5.25%
Home Price	$250,000
Loan-To-Value %	95%
Loan Amount	$237,500

Example 95% LTV Loan to a FICO 630 borrower:

1. GSE delivery fees sum to 300 basis points, or $7,125 on the $237,500 loan amount
2. Lender must charge as points to borrower (additional cash at closing) or "premium price" into note rate
3. Estimated amount of note rate increase required to generate 300 basis points of additional loan price is 75 basis points
4. Monthly payment increase created by the additional note rate is $112

(a- Adverse Market and FICO Based fees first introduced by GSEs in November 2007

Impact Of GSE LLPAs - $250,000 Home, 95% Loan

FICO Score	Total LLPA % -a)	Total LLPA $	Borrower Note Rate Impact	Borrower Payment Impact	Affordable Home Impact	Loss of Affordability	Loss of Affordability %
>= 740	0.25%	$594	0.06%	$9	$248,820	$1,180	0.5%
720 - 739	0.25%	$594	0.06%	$9	$248,820	$1,180	0.5%
700 - 719	0.75%	$1,781	0.19%	$28	$246,570	$3,430	1.4%
680 - 699	1.00%	$2,375	0.25%	$37	$245,454	$4,546	1.8%
660 - 679	2.00%	$4,750	0.50%	$75	$241,058	$8,942	3.6%
640 - 659	2.50%	$5,938	0.63%	$93	$238,898	$11,102	4.4%
620 - 639	1 3.00%	2 $7,125	3 0.75%	4 $112	5 $236,765	6 $13,235	7 5.3%
< 620	3.25%	$7,719	0.81%	$122	NA	NA	NA

Assumptions:

Base Note Rate:	5.25%
Home Price	$250,000
Loan-To-Value %	95%
Loan Amount	$237,500
HDTI Ratio	31%

Example 95% LTV Loan to a FICO 630 borrower:

1. GSE delivery fees sum to 300 basis points, or $7,125 on the $237,500 loan amount
2. Lender must charge as points to borrower (additional cash at closing) or "premium price" into note rate
3. Estimated amount of note rate increase required to generate 300 basis points of additional loan price is 75 basis points
4. Monthly payment increase created by the additional note rate is $112
5. Borrower who could have afforded a $250,000 home now limited to $236,765 due to LLPA fees.
6. Loss of affordability due to LLPA fees.
7. Loss of affordability due to LLPA fees, expressed as a percent of $250,000 original home price

(a- Adverse Market and FICO Based fees first introduced by GSEs in November 2007

FHA EXAMPLE

LOS ANGELES, CAL.

Financing
FHA LOAN
LOS ANGELES, CA

Sale Price	250,000.00
HUD Reposession	No
FHA Condo	No
Number of Units	1
Condo	No
Interest Rate	5.000
Term on 1st Trust Deed	30.0
Down 3.50%	8,750.00
1st Trust Deed	241,250.00
MIP 2.25%	5,428.13
Total 1st TD	246,678.13
Payment 5.000%	1,324.21
Property Insurance 3.60%	75.00
Property Tax 1.25%	260.43
Mortgage Insurance 0.55%	110.57
Mello-Roos 0.00%	0.00
Flood/Quake 0.00%	0.00
Association Fee	0.00
Total Pmt/Month	1,770.21

FHA EXAMPLE

2

LOS ANGELES, CAL.

Financing
FHA LOAN
LOS ANGELES, CA

Sale Price	**250,000.00**
HUD Reposession	No
FHA Condo	No
Number of Units	1
Condo	No
Interest Rate	5.000
Term on 1st Trust Deed	30.0
Down 3.50%	8,750.00
1st Trust Deed	241,250.00
MIP 2.25%	5,428.13
Total 1st TD	246,678.13
Payment 5.000%	1,324.21
Property Insurance 3.60%	75.00
Property Tax 1.25%	260.43
Mortgage Insurance 0.85%	170.89
Mello-Roos 0.00%	0.00
Flood/Quake 0.00%	0.00
Association Fee	0.00
Total Pmt/Month	1,830.53

FHA EXAMPLE

LOS ANGELES, CAL.

3

Financing
FHA LOAN
LOS ANGELES, CA

Sale Price	250,000.00
HUD Repossession	No
FHA Condo	No
Number of Units	1
Condo	No
Interest Rate	5.000
Term on 1st Trust Deed	30.0
Down 3.50%	8,750.00
1st Trust Deed	241,250.00
MIP 2.25%	5,428.13
Total 1st TD	246,678.13
Payment 5.000%	1,324.21
Property Insurance 3.60%	75.00
Property Tax 1.25%	260.43
Mortgage Insurance 1.55%	311.61
Mello-Roos 0.00%	0.00
Flood/Quake 0.00%	0.00
Association Fee	0.00
Total Pmt/Month	1,971.25

MARK ALSTON

Mark Edward Alston, Owner of Alston & Associate Mortgage/Skyway Realty, he also currently is the 1st Vice- President of Consolidated Board of Realtist and Chairman of the Political Action Committee.

Mark has been in the Real Estate profession since 1989, first employed by Trent Financial Inc. Where he was honored as "Rookie of the Year"; in 1993 he received recognition as "Top Producer". In 1994 he was promoted to one of the Vice-President of the Company.

1997, Mark entered partnership with RMB investments Company as the President. After three years he left RMB and August 2000 started his own company, Alston & Associates Mortgage/ Skyway Realty.

Mark has always been a highly motivated public speaker and often called on to speak and educate on all areas of real estate from mortgage banking to real estate law. During his 21 years of Mortgage banking and real estate he is known for his excellent work ethics driven by his integrity, loyalty and a brilliant, inquisitive mind – Mark believes that it is important to give back to his Community. For years Mark has mentored many young people and shortly after the inception of his company, Mark regularly instructs a free all-phases mortgage training program which has produced at least two to three hundred successful men and women.

Some of Mr. Mark Edward Alston's past achievements and current involvements are:

- Recognized by Congresswoman Diane Watson (JUGS) "Outstanding Work in Community Award"
- Los Angeles County Board of Supervisors "Outstanding Achievement in His Community Award"
- City of Los Angeles "Outstanding Community Achievement Award"
- City of Inglewood "Outstanding Community Achievement Award"
- Member and past Vice-President, Cosmopolitan Golf Club (the oldest Minority Golf Club in the Northwest)
- Member, California Brokers Association
- Member, Consolidated Board of Realtist
- Member, Southwest Board of Realtors
- Past Member, Board of Directors of Mini-House Recovery Home for Women
- Past President, Home Mission Department, Louisiana Progressive Baptist State Convention
- Board member with the NAACP in Seattle, WA
- Member of the National Association of Real Estate Brokers

Prepared Testimony

of

Mike Anderson, CRMS
Vice Chairman of Government Affairs

National Association of Mortgage Brokers

on

"The FHA Reform Act of 2010"

Before the

Committee on Financial Services,
Subcommittee on Housing & Community Opportunity

United States House of Representatives

March 11, 2010

Good afternoon Chairwoman Waters, Ranking Member Capito, and members of the Committee. I am Mike Anderson, Vice Chairman of Government Affairs for the National Association of Mortgage Brokers ("NAMB"). I am a Certified Residential Mortgage Specialist ("CRMS") and an FHA-Approved Loan Correspondent with over 31 years of experience as a mortgage professional in the State of Louisiana. Thank you for inviting me to testify today on "The FHA Reform Act of 2010."

I. Introduction

The National Association of Mortgage Brokers is the voice of the mortgage broker industry, representing the interests of mortgage professionals and homebuyers nationwide. Established in 1973 and headquartered in McLean, Virginia, NAMB is the oldest and largest national trade association representing the mortgage broker industry.

Today, NAMB advocates on behalf of more than 70,000 small business mortgage professionals located in all 50 states and the District of Columbia. NAMB also represents the interests of homebuyers, and advocates for public policies that serve mortgage consumers by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to enhancing consumer protection and promoting the highest degree of professionalism and ethical standards for its members. NAMB requires its members to adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. NAMB also provides its members with access to professional education opportunities and offers rigorous certification programs, including the CRMS, to recognize members with the highest levels of industry knowledge and education.

Additionally, NAMB serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

NAMB members are typically small business owners, employing between three and fifty employees. They serve both urban and rural communities of every size, and operate in all 50 states and the District of Columbia. NAMB members work with consumers as they make their way through the complex mortgage origination process, and add value to that process for both consumers and lenders by serving many areas that are typically underserved by banks and other financial institutions. Because many NAMB members establish and operate their businesses exclusively within the communities they serve, these individuals also add value to the origination process by providing goods, facilities, and services with quantifiable value, including a loyal customer base and goodwill.

NAMB members, together with the rest of the mortgage broker industry, bring greater competition to the market for origination services and typically provide consumers with a local alternative to using a large national bank or lender.

II. Background

Last year, the Department of Housing & Urban Development ("HUD") began announcing a series of significant changes to the Federal Housing Administration ("FHA") loan program designed to strengthen FHA's capital reserves and better manage its exposure to risk. In addressing the changes, FHA Commissioner David Stevens commented that risk management and credit policy changes at FHA are needed in today's market to strengthen the insurance fund and help ensure that lenders have proper and sufficient protections.

Many of these changes have already been implemented through administrative measures such as the issuance of Mortgagee Letters, or are currently being finalized as part of the notice and comment rulemaking process. However, other FHA policy changes sought by HUD require specific legislative action, which is the subject of today's hearing.

In this written testimony, NAMB will discuss the specific legislative changes proposed in the FHA Reform Act of 2010 ("Reform Act"), as well as the administrative policy changes that have already been implemented by HUD or will soon take effect. NAMB supports many of the changes that have been made or are currently being pursued by HUD, and NAMB applauds Commissioner Stevens for his dedicated efforts to strengthen and protect the FHA loan program and the FHA insurance fund. Nevertheless, NAMB does have a number of serious concerns about certain aspects of the policy changes taking effect at FHA, and we would like to work with HUD and this Committee to resolve some of these issues.

III. FHA Reform Act of 2010

The FHA Reform Act of 2010 ("FHA Reform Act") contains three specific changes to current FHA policy, which were sought by HUD in its January 20, 2010 announcement of additional administrative policy changes. Specifically, the FHA Reform Act would grant FHA the authority to increase annual mortgage insurance premiums ("MIP") charged to borrowers beyond their current statutory cap; ensure that lenders are required to indemnify the Secretary for any losses on loans they originate or underwrite; and give the Secretary an enhanced ability to review mortgagee performance and terminate FHA-approval if necessary.

a. Authorization to Increase Annual Mortgage Insurance Premium

Section 203(c)(2)(B) of the National Housing Act (12 U.S.C. 1709(c)(2)(B)) currently requires the Secretary to establish and collect annual MIP payments in an amount not exceeding 0.50 percent of an FHA borrower's insured principal balance on a loan, for loan amounts less than 90 percent of the appraised value of the property. This Section also requires the Secretary to collect annual MIP payments in an amount not exceeding 0.55 percent on loan amounts greater than 95 percent of the appraised property value.

The FHA Reform Act amends Section 203(c)(2)(B) of the National Housing Act (12 U.S.C. 1709(c)(2)(B)) to permit, but not require, the Secretary to establish and collect annual MIP payments from FHA borrowers in an amount not exceeding 1.50 percent of the insured principal balance on a loan for loan amounts less than 90 percent of the appraised value of the property, and 1.55 percent on loan amounts greater than 95 percent.

NAMB is concerned this policy change will cause an increase in costs for FHA borrowers, particularly at a time when so many families are struggling financially and our mortgage and housing markets remain in crisis. While we understand the adverse effect that the housing market collapse and subsequent foreclosure crisis have had on FHA's capital reserves, we do not believe that such a significant increase in the annual MIP charged to borrowers is the answer.

Each time mortgage costs are increased for consumers, whether in the conventional or FHA market, a segment of the potential home buying population is eliminated from that market. For example, a borrower today with an annual income of $75,000 and monthly debts totaling $600 could make the minimum downpayment of 3.5 percent, receive an interest rate of 4.75 percent, and qualify through FHA to purchase a $205,000 home. However, if the proposed increase in annual MIP is implemented, this same borrower would only qualify to purchase a $185,000 home. This is the cost equivalent of a 1.25 percent interest rate increase. What is worse, when interest rates rise, the maximum purchase price this same borrower could qualify for through FHA decreases even more dramatically. With an interest rate of just 6.25 percent, the borrower in this example would only qualify to purchase a $165,000 home.

Additionally, the proposed across-the-board increase in annual MIP is effectively a mandate requiring borrowers in States with low default rates to subsidize the unusually high rate of claims in certain geographic areas. NAMB does not believe that FHA should be instituting changes that will price otherwise qualified and eligible borrowers out of the market or require high-performing States to pay the price for those actually responsible for FHA's depleted capital reserves.

For these reasons, NAMB respectfully urges this Committee to amend the proposed legislation we are discussing today and reject the increase in annual MIP that FHA is seeking authority to implement. However, if the Committee feels it is necessary and appropriate to grant FHA this authority, NAMB

encourages the Committee to direct FHA to properly account for default rates, credit risk, or both when implementing the change in annual MIP charged to borrowers.

b. Indemnification by Mortgagees

The FHA Reform Act amends Section 202 of the National Housing Act (12 U.S.C. 1708) by adding a new section that would ensure all direct endorsement mortgage lenders are liable to indemnify the Secretary for any loss on loans they originate or underwrite. This Section would allow the Secretary to require indemnification if a mortgage approved by the Secretary under the direct endorsement program or insured by a mortgagee pursuant to a delegation of authority under section 256 was not originated or underwritten in accordance with requirements established by the Secretary, and the Secretary pays an insurance claim within a reasonable period of time, which is specified by the Secretary. The Secretary would also be entitled to indemnification if fraud or misrepresentation was involved in connection with the origination or underwriting of the loan, regardless of when an insurance claim is paid.

NAMB supports requiring FHA-approved Mortgagees to indemnify the Secretary for losses incurred by the agency on insured loans that are originated and/or underwritten outside of FHA guidelines and requirements. It is critical to the future health and prosperity of the FHA loan program that participants adhere to the established guidelines and are held accountable if and when they fail to do so. However, informed professionals often interpret FHA's guidelines differently. Indemnification requests should have due process and be appealable. NAMB understands that the process should not be so complex as to totally impair indemnification nor should it be an arbitrary action by HUD merely as a tool to recover losses.

c. Review of Mortgagee Performance

Section 4 of the FHA Reform Act amends section 533 of the National Housing Act (12 U.S.C. 1735f-11) to give the Secretary an enhanced ability to review mortgagee performance and, if a mortgagee is found to have an excessive rate of early defaults or claims, to terminate the mortgagee's approval to originate or underwrite single family mortgages in a specified area or areas, or on a nationwide basis.

NAMB is very supportive of measures to enhance the accountability of participants in the FHA program. However, we are concerned that in our current economic environment, otherwise responsible lenders, particularly in some of the hardest hit geographic areas, will show uncharacteristically high rates of defaults and claims that could threaten their approval as a mortgagee.

Protections should be put into place to ensure that FHA's enhanced ability to review mortgagee performance takes into consideration the longer-term performance history of loans originated and/or underwritten by the mortgagee, along with market forces and factors outside of the mortgagee's control, which may have contributed to uncharacteristically high default rates or claims in certain geographic areas or over a specific period of time.

FHA should consider whether a mortgagee is making loans to underserved borrowers resulting in a higher than average default rate. Since this is a primary mission of FHA, mortgagees should be able to offer this defense before any action is taken by HUD. Termination should have warnings, notice, and appeal rights.

Additionally, if and when FHA deems it necessary to terminate a mortgagee's approval, NAMB believes it is imperative that guidelines be put into place to help retrieve FHA loans already in the pipeline, so as to avoid any repeat of the situation that transpired in the wake of FHA's termination of Taylor, Bean & Whitaker last year. A model exists in many State Banking Divisions already, and NAMB believes that

FHA should devise and implement a similar model that would help protect consumers as FHA seeks to expand its enforcement authority and its ability to terminate mortgagees' approval.

IV. Regulatory & Administrative Changes Proposed by FHA on January 20, 2010

a. Increased Upfront Mortgage Insurance Premium

Effective April 5, 2010, FHA will increase its upfront MIP charged to borrowers by 50 basis points to 2.25 percent. According to FHA, the upfront MIP increase is designed to build up capital reserves and help bring back private lending. FHA believes that the first step is to raise the upfront MIP, and then seek legislative authority to increase the maximum annual MIP, with the idea that some of the consumer cost burden from the upfront MIP may then be shifted to the annual MIP. This, FHA contends, will allow for capital reserves to increase with less impact to the consumer, because the annual MIP is paid over the life of the loan instead of at the time of closing.

NAMB is concerned about the proposed change in upfront borrower MIP costs for a number of reasons, particularly when it is coupled with the proposed increase in annual MIP. First, as we discussed above with regard to increasing the annual MIP, NAMB does not believe this is the right economic environment to be raising consumer costs and likely pricing qualified borrowers out of the market. Second, high-cost rules in various states place caps on the total allowable points and fees in a mortgage transaction, and these rules often do not exclude FHA's upfront MIP from the high-cost calculation. The proposed increase in upfront MIP will bring FHA loans under the high-cost rules in number of states and under Truth-In-Lending regulations, and therefore will basically destroy the FHA market in those states.

Finally, raising the upfront MIP may increase FHA's capital reserves, but it also increases FHA's exposure to risk. Because the upfront MIP may be financed by borrowers and rolled into the principal balance of the loan, borrowers will have less equity in their property and FHA will be insuring higher loan-to-value mortgages.

b. Increased Credit Score & Downpayment Requirements

FHA has proposed updating its credit score and downpayment requirements for new borrowers, effective as early as this summer. Borrowers who possess a credit score of 580 or above would be required to make the current 3.5 percent minimum downpayment, while borrowers with a credit score below 580 would be required to make a minimum 10 percent downpayment to be eligible for FHA. FHA believes that this allows the agency to better balance its risk and continue to provide access to the program to those borrowers who have historically performed well.

NAMB is concerned that these new credit score and downpayment requirements may be too restrictive, and could ultimately have a significant negative impact on FHA's origination volume. Traditionally, borrowers with high credit scores have not chosen to utilize FHA. However, in today's market, because GSE fees tied to borrowers' credit scores have increased dramatically, many of these borrowers are moving away from conventional loans and opting instead for FHA products. This trend may not continue after the conventional mortgage market recovers, and FHA could risk losing significant market share back to the GSEs if only the very best borrows are eligible for participation in the loan program.

While NAMB supports FHA's desire to ensure that only quality loans are insured by the agency, NAMB has concerns about FHA's proposed changes to the downpayment and credit score requirements for borrowers. NAMB strongly believes that FHA should not seek to establish such restrictive requirements that only the very best borrowers can qualify for the program.

c. *Reduction in Allowable Seller Contributions*

FHA has also proposed limiting the total amount of seller concessions that an FHA borrower is eligible to receive, in an effort to conform to industry standards and reduce the risk to FHA posed by potential value inflation.

NAMB opposes any reduction in the amount of allowable seller concessions. Throughout the country, there is a surplus of homes on the market and there are qualified buyers seeking to enter the market. However, in these economic times, many borrowers lack the cash necessary to cover all of the upfront costs associated with obtaining a mortgage and purchasing a home. Although it is true that FHA currently allows nearly double what the conventional market will accept as allowable seller concessions, such concessions are critical to countless buyers who would otherwise not be able to afford the purchase of their home.

V. Regulatory & Administrative Changes Proposed Prior to January 20, 2010

HUD announced its first in this series of policy changes on September 18, 2009. Among the changes announced were new appraisal standards, modified procedures for streamlined refinance transactions, and new approval and participation requirements for mortgagees and loan correspondents.

NAMB believes that these new policies will have a profound effect on the FHA program. As with many of the new policies which we have already discussed, NAMB is supportive of some of the Commissioner's efforts to improve the FHA program, and we would like to specifically thank Commissioner Stevens for proposing removal of the burdensome and unnecessary audit requirement for loan correspondents.

At the same time however, NAMB believes that there are flaws in some of the new FHA policies, particularly with regard to appraisals, that must be worked out to ensure that the program continues to run efficiently and effectively into the future.

a. *Appraiser Independence*

New FHA appraisal ordering took effect February 15, 2010. FHA believes that these new guidelines will enhance appraiser independence and geographic competence. The new guidelines prohibit mortgage brokers and commission-based lender loan officers from ordering appraisals, much like the Home Valuation Code of Conduct ("HVCC"), which was implemented by Fannie Mae and Freddie Mac (together, "the GSEs") in May 2009.

The HVCC is a highly controversial shift in appraisal policy that resulted from a joint agreement reached between the GSEs, the Federal Housing Finance Agency ("FHFA"), and New York Attorney General, Andrew Cuomo. The HVCC purports to enhance the independence and accuracy of the appraisal process. However, what the HVCC truly accomplishes is an increase in consumer costs, a decline in appraisal quality, the extension of closing deadlines, and the virtual extinction of independent appraisers.

Although FHA has varied the provisions of the HVCC slightly in Mortgagee Letter 2009-28, these variations are unlikely to allow FHA to escape any of the serious issues currently facing consumers and originators in the conventional mortgage market as a result of the HVCC.

NAMB believes it is important to strengthen the integrity and independence of the home appraisal process, as appraiser independence is essential to protecting consumers and the FHA insurance fund from fraud and unnecessary risk. However, NAMB does not believe the HVCC, or the new FHA appraisal guidelines, will effectively achieve these goals.

The impetus behind these new appraisal policies – the HVCC and the new FHA guidelines – is the perception that appraisers were being pressured or improperly influenced by mortgage originators. However, the HVCC is failing to provide any greater protection for appraisers. Appraisers are still subjected to significant pressure and undue influence, but instead of coming from mortgage originators it is now coming from the Appraisal Management Companies ("AMCs") that were granted a virtual monopoly over the appraisal process by the HVCC.

In fact, a growing number of appraisers are reporting that the pressure and attempts to improperly influence their professional judgment is far worse under the AMC-dominated regime prescribed by the HVCC than it ever was when appraisers were permitted to work directly with originators. Specifically, appraisers are reporting that AMCs are requiring them to prepare appraisals in violation of the Uniform Standards of Professional Appraisal Practice ("USPAP") and generally accepted appraisal guidelines.

Today, unlike when an appraiser had multiple mortgage broker and/or loan officer clients, the HVCC has restricted their work to be on behalf of only one or possibly two AMCs. Under this construct, if an appraiser fails to comply with any AMC "request," they will no longer receive appraisal assignments from possibly their only client. With many knowledgeable and skilled appraisers unwilling to work under such conditions and consequently leaving the profession, the appraisers that remain willing to work for the AMCs are generally far less qualified and experienced. This has resulted in a rapid decline in appraisal quality since the implementation of the HVCC, which directly contradicts the widely purported view of HVCC proponents that turning over virtually exclusive authority for appraisal ordering to third-party AMCs would produce more accurate appraisals.

Although it can be fairly said that conducting appraisals is both a science and an art form, there is evidence showing that multiple appraisals ordered on the same property under the HVCC can vary by more than 20%. While it is unrealistic to expect multiple appraisals to come in with values that fall within a tight tolerance window, the extremely large variances we are seeing on multiple appraisals under the HVCC are cause for great concern. As the quality of appraisals goes down, there is a high likelihood that these poorly conducted home valuations will further deteriorate the already weak housing market.

Moreover, with the virtual elimination of all competition in the market for home appraisals, AMCs have reduced appraisers' fees by as much as 50%, while at the same time increasing consumer costs for appraisals by more than 50%. NAMB members are reporting an increase in consumer costs between $50 and $150 per appraisal. HUD believes it has solved this problem by making the AMCs pay rates that are "customary and reasonable" for the area where a property is located. However, with AMCs dominating the market and most AMCs underpaying appraisers for their work, it will likely prove to be extremely difficult to establish what "customary and reasonable" really means.

NAMB strongly opposes FHA's decision to follow in the footsteps of the HVCC, given its glaring weaknesses and failures in the short time since it has taken effect. Moreover, NAMB believes FHA already has a more effective mechanism in place for assuring appraiser independence, as every FHA appraisal is reviewed by the sponsoring direct endorsement lender's underwriter prior to loan approval. This system of checks has served FHA well for years and we believe would continue to do so in the absence of the proposed new appraisal guidelines. Finally, NAMB believes that adequate additional safeguards were put in place by the amendments to Regulation Z of the Truth-in-Lending Act, which took effect October 1, 2009.

Prior to the effective date of these new appraisal guidelines, FHA was the only remaining segment of the market where independent appraisers could receive a fair wage and operate without unreasonable pressure, scrutiny, or restraints. NAMB strongly encourages HUD to consider withdrawing Mortgagee Letter 2009-28 and engage representatives from both the mortgage and appraisal industries in meaningful discussions of alternative approaches prior to implementing the proposed guidelines or any other significant changes to the appraisal ordering process for FHA.

b. Appraisal Portability

Mortgagee Letter 2009-29 specifically addresses the issue of appraisal portability, which is another tremendous problem created by the HVCC. FHA's new guidelines would allow a second appraisal to be ordered under a limited set of circumstances when a borrower switches from one lender to another and restates the requirement that the first lender must transfer the appraisal to the second lender at the request of the borrower. These new guidelines are designed to prevent delays in closing that often occur when a loan is transferred from one lender to another.

NAMB strongly supports FHA's effort to increase appraisal portability. However, we are concerned that this new FHA policy, as written, will fail to achieve its intended goal. As long as mortgage brokers are prohibited from ordering appraisals for their customers, they cannot be identified as the "client," and the appraisal will not truly be portable.

Appraisals are addressed to the "client" who orders the appraisal. USPAP prohibits the "readdressing" of appraisals. When mortgage brokers order an appraisal, the broker is the "client" and that appraisal may be freely transferred to any FHA-approved sponsoring lender with whom the broker maintains a relationship. However, if lenders are required to order the appraisal and are identified as the "client," not even HUD's mandate that an appraisal must be transferred from one lender to another upon a borrower's request will permit readdressing the appraisal to the second lender. Moreover, even if a transfer of the appraisal was lawful, the time that would almost certainly be lost in that process would prove to be severely damaging to the borrower.

c. Modified Procedures for Streamlined Refinance Transactions

On January 1, 2010, FHA implemented changes to certain procedures for streamline refinance transactions to: establish new requirements for seasoning, payment history, income verification, and demonstration of net tangible benefit to the borrower; provide for collection of credit score information when available; and cap the maximum loan-to-value ratio at 125%. An appraisal is required in all cases where a borrower wants to add even minimal closing costs to the transaction.

NAMB understands HUD's rationale that these revisions were to bring documentation standards for streamline refinance transactions in line with other FHA loan origination guidelines, ensure a borrower's capacity to repay the new mortgage, and prohibit the dangerous practice of loan churning, where borrowers raise cash through successive cash-out refinancings that put them further in debt. However, NAMB is concerned that many borrowers will not be able to refinance to a lower rate, which could possibly increase the default rate rather than provide an equity cushion. Borrowers who are demonstrating financial responsibility despite hardship are being prevented from a deserved lower interest rate. When a borrower shows they have both the desire and ability to maintain his/her payments without traditional proofs of income, he/she should be allowed to refinance to a lower rate and payment.

d. Elimination of FHA Approval Requirements for Loan Correspondents

In a Proposed Rule published November 30, 2009, HUD sought to change the eligibility criteria for FHA lender approval. Under the Proposed Rule, loan correspondents would no longer be eligible to receive independent FHA-approved status. Rather, FHA lender approval would be limited to mortgagees.

According to HUD, this limitation reflects recognition that the mortgagee, by underwriting, servicing or owning a loan, is the most critical lending party to a mortgage transaction, and as such should be the party that is subject to FHA's rigorous lender approval and oversight processes.

Under the Proposed Rule, loan correspondents would continue to be authorized to participate in the origination of FHA loans through association with a FHA-approved mortgagee, but these entities would no longer be subject to the FHA lender approval process. Some who commented on the proposed rule have pointed out that the new rule would prevent anyone from originating a HECM (reverse mortgage) unless they were an employee of the largest lenders. This is a serious consequence of eliminating correspondent status for smaller companies' altogether.

NAMB has long advocated for changes to the FHA approval process that would help a greater number of third-party originators become eligible to originate FHA loans. Therefore NAMB is very supportive of HUD's decision to eliminate the independent approval requirement for loan correspondents. By removing the overly burdensome financial audit and net worth requirements that are currently in place for third-party originators, HUD is creating an opportunity for a greater number of third-party originators to participate in the FHA loan program and is allowing third-party originators to operate in a fashion similar to that which exists under current Fannie Mae & Freddie Mac guidelines.

Nevertheless, NAMB is concerned that disconnecting loan correspondents from the FHA system fails to adequately account for the widely varied participants in today's mortgage market. In its comment letter, NAMB strongly urged HUD to modify the Proposed Rule and grant loan correspondents full access to the FHA Connection, as well as the authority to obtain FHA case numbers and assign FHA-approved appraisers.

FHA loan correspondents take on various forms, including small banks that lack the staff to perform all FHA functions, independent mortgage bankers who do not desire to service FHA loans and mortgage brokers who possess the requisite expertise but need a funding partner. This is why NAMB believes it is important for loan correspondents to maintain some status with HUD and the FHA, and retain access to the FHA system. Specifically, NAMB believes loan correspondents must be able to obtain case numbers for FHA loans and communicate directly with the FHA. The inability to communicate with FHA or access FHA websites will pose serious issues for loan correspondents attempting to determine whether a borrower is eligible for FHA financing.

e. Requirement for Sponsoring Mortgagees to Supervise Loan Correspondents

In the same November 30, 2009 Proposed Rule, HUD also sought to require FHA-approved mortgagees to assume responsibility for ensuring that any loan correspondent sponsored by the mortgagee meets all applicable requirements.

The FHA-approved mortgagee would continue to act as a sponsor, as it has in the past. However, in establishing a sponsor-correspondent relationship, the mortgagee would be required to assume responsibility for the actions of any loan correspondent working with the mortgagee on a FHA loan transaction, for activities related to loan origination.

Specifically, FHA-approved mortgagees would be required to ensure that their sponsored loan correspondents comply with all requirements that make loans eligible for FHA insurance. Mortgagees must also ensure that loan correspondents meet established standards for demonstrating integrity and financial soundness, including those standards emphasized in the Helping Families Save Their Homes Act. Additionally, mortgagees would be responsible for ensuring that all parties to an FHA transaction comply with FHA's requirements regarding loan origination, processing, underwriting, and servicing found in relevant statutes, regulations, HUD handbooks, and mortgagee letters. Finally, the FHA-approved mortgagee would be required to assume liability for any FHA-insured loan underwritten and closed in the name of the mortgagee.

In its comment letter, NAMB expressed concern that the Proposed Rule goes too far in transferring all supervisory authority over loan correspondents from HUD to sponsoring FHA-approved mortgagees. NAMB believes that it is proper for HUD to establish some standards for loan correspondents that may be reasonably supervised by sponsoring mortgagees. However, some tracking and control functions are better performed by a government agency. For this reason, NAMB strongly believes the oversight of loan correspondents should be shared between HUD and the sponsoring FHA-approved mortgagees. For these reasons, NAMB encouraged HUD to revise the Proposed Rule and provide for more balanced, dual oversight of loan correspondents.

f. Requirement that Loans be Underwritten and Closed in the name of the FHA-Approved Mortgagee

HUD has also proposed a requirement that all FHA-insured mortgages be underwritten and closed in the name of the FHA-approved mortgagee. NAMB does not support the requirement that all loans must be underwritten and closed in the name of the FHA-approved mortgagee. Such a requirement is inconsistent with current practices under GSE and VA loan programs, conflicts with various state and federal laws, and will create issues in numerous states where loan correspondents function as lenders or table-funding entities.

It is a common misperception that the term loan correspondent is synonymous with mortgage broker. In reality, FHA loan correspondents take various forms, including small banks that lack the staff to perform all FHA functions, independent mortgage bankers who do not desire to service FHA loans, and mortgage brokers who possess the requisite expertise but need a funding partner. The requirement in the Proposed Rule that all FHA-insured loans be underwritten and closed in the name of the approved mortgagee effectively declares any entity that is not a FHA-approved mortgagee is a mortgage broker, irrespective of the entity's net worth, typical market function, or classification under different state laws and regulations.

By effectively changing the classification of such entities, the Proposed Rule could impose a number of unintended economic burdens on formerly FHA-approved loan correspondents. For example, these entities may need to obtain further licensing under state laws with regard to mortgage brokering (as opposed to mortgage lending) activities. Additionally, state law may impose limitations on the fees these entities are permitted to charge when acting in a mortgage broker capacity. Finally, these entities will be required to provide different disclosures to consumers under the Real Estate Settlement Procedures Act ("RESPA") and various state laws when acting as a mortgage broker, as opposed to a lender.

g. Increased Net Worth Requirements for FHA-Approved Mortgagees

Finally, HUD included provisions in the November 30, 2009 Proposed Rule that would increase the net worth requirement for FHA-approved mortgagees in an effort to comport with current industry standards. The current net worth requirement for mortgagees approved by FHA is $250,000. This figure has not increased since 1993.

The Proposed Rule would initially increase the minimum net worth requirement to $1 million, with at least twenty percent of that figure being liquid assets consisting of cash or its equivalent. Within three years after enactment of this rule, the minimum net worth required for mortgagees would be increased to $2.5 million, with at least twenty percent of that amount consisting of liquid assets.

The Proposed Rule cites the recent rise in net worth requirements by Fannie Mae and Ginnie Mae as evidence supporting the increase for FHA-approved mortgagees. However, this comparison is flawed because FHA is more akin to a Private Mortgage Insurance ("PMI") company than to Ginnie Mae or the GSEs. While it is reasonable for Ginnie Mae to establish and maintain criteria similar to that set by the GSEs, since these entities perform similar functions, it is unreasonable and excessive for FHA to impose such requirements when its contemporaries – the PMI companies – require no similar net worth.

NAMB is concerned about an increased net worth requirement for two primary reasons. First, it would tend to concentrate power and control in the hands of only the largest lenders. Under such a scenario, when a large entity fails, the resulting losses could severely destabilize the FHA insurance fund. Also, there is a real risk that providing the largest lenders with a virtual monopoly will result in higher costs and other adverse consequences for consumers and small businesses. For example, the increased net worth requirement is likely to force many smaller entities to surrender their FHA-approved mortgagee status.

However, because the Proposed Rule will require the few remaining FHA-approved mortgagees to assume responsibility for their sponsored loan correspondents, it is fair to assume the supply of correspondents will greatly exceed the demand and risk tolerance of mortgagees for sponsoring these correspondents. The net result will be fewer entities originating FHA loans, as many highly qualified originators will be forced out of the FHA market altogether, due to lack of sponsorship and insufficient capital to obtain independent approval.

Second, net worth has been shown to evaporate in mere days, meaning the satisfaction of a net worth requirement, no matter how large, can create a false sense of security. To date, there has been no link made between loan quality or performance and net worth. Eliminating high-quality mortgagees simply on the basis of net worth could have an inverse effect and actually harm the quality of FHA loan production.

Instead of establishing an unreasonably high net worth requirement, NAMB urged HUD to explore implementation of a recovery fund, whereby every FHA-approved mortgagee must contribute to the fund in order to originate, fund or service an FHA loan. Such an alternative would be similar to the current standard requirements for any person that wants to become licensed in a state pursuant to the SAFE Act.

Additionally, NAMB encouraged HUD to explore other alternatives to increasing the net worth requirements as proposed, including establishing tiered net worth requirements based on volume.

VI. FHA is Not the New Subprime

With the collapse of the subprime market, there is some concern that the problems leading to that collapse will begin to creep into the FHA market and expose the FHA insurance fund to greater risk. NAMB strongly believes that the FHA rules and guidelines currently in place, together with the strong and positive FHA policy changes and larger reforms affecting the entire mortgage industry, will be sufficient to prevent this from happening.

The SAFE Act has significantly increased professional standards and accountability for all mortgage originators. Today, as opposed to during the peak of the subprime lending boom, it is extremely difficult

for bad actors to enter, remain, or move within the mortgage industry to prey on consumers. Additionally, FHA imposes its own requirements for mortgagees and loan correspondents, which further vets the individuals and entities that may be approved to participate in the program. Finally, much like originators, borrowers using FHA must adhere to higher standards than the ones which existed in the subprime market. Some of these higher standards include income verification, mandatory downpayment requirements and strict loan-to-value ratios. FHA also does not permit many of the loan product features, such as prepayment penalties, huge payment spikes, and negative amortization, which exposed borrowers and lenders to greater risk and were prevalent in so many loans made in the subprime market, and FHA requires borrowers to occupy the home they are purchasing as their primary residence, which was never a requirement in the subprime market.

There has almost certainly been some migration of mortgage originators from the subprime market over to FHA, since a significant majority of the mortgage industry was involved in some way with subprime lending. However, with the safeguards in place at FHA and throughout the mortgage industry, this migration should not be viewed as a threat to the FHA program, but rather as a tremendous opportunity for growth. Now, perhaps more than ever, highly qualified and well-established mortgage originators are again looking to FHA as a means of offering an affordable loan product to their customers. This renewed interest in the FHA program, coupled with heightened standards for every mortgage originator who wishes to remain in the industry, should position FHA to recapture much of the market share that was lost to the subprime market over the past decade.

VII. Conclusion

NAMB and the mortgage professionals we represent are very interested in maintaining a strong, healthy and relevant FHA loan program. FHA has been an innovator as well as an engine driving the housing market in this country. Not since the Great Depression has FHA's role been so vital.

Thank you for inviting NAMB to testify today and offer our perspective on "The FHA Reform Act of 2010," as well as the many administrative and regulatory changes to FHA proposed and implemented by HUD in recent months. We are grateful for the opportunities we have had to work with HUD and this Committee on a variety of issues, and we look forward to building and strengthening these relationships as we continue to work together to improve the strength and soundness of the FHA loan program.

THE IMPACT OF FHA REFORM ON LATINO AND OTHER UNDERSERVED COMMUNITIES

Presented at:

"The FHA Reform Act of 2010"

Submitted to:
U.S. House Committee on Financial Services
Subcommittee on Housing and Community Opportunity

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March 11, 2010

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Good afternoon. My name is Graciela Aponte. I am the Legislative Analyst for the Wealth-Building Policy Project at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic[1] civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. I conduct legislative analysis and advocacy on issues pivotal to building financial security in Latino communities, such as affordable homeownership, foreclosure prevention, consumer credit, financial counseling, and credit scoring. For more than seven years, I have been working on issues that impact low-income communities, providing assistance to constituents and nonprofit community-based organizations on behalf of congressional representatives in Maryland and New York City. Prior to joining NCLR, I worked in Prince George's County, Maryland as a bilingual housing counselor at a housing counseling agency that was approved by the U.S. Department of Housing and Urban Development (HUD). I was honored by HUD for outstanding assistance and having a direct impact on the Latino community, making homeownership a reality for many. In addition, I currently serve on the Consumer Advisory Council for the American Association of Residential Mortgage Regulators (AARMR). On behalf of NCLR, I would like to thank Chairwoman Maxine Waters and Ranking Member Shelley Moore Capito for inviting us to share our views on this important topic.

For more than two decades, NCLR has advocated for policies and programs that support sustainable Hispanic homeownership. NCLR conducts research and analysis on relevant public policy issues, such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Owner Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to credit. In addition, NCLR is the only HUD-approved housing counseling intermediary dedicated to serving the Latino community. The NCLR Homeownership Network (NHN) provided first-time homebuyer and foreclosure prevention counseling to more than 50,000 families last year alone. NHN counselors are working closely with FHA borrowers to ensure that they are prepared for homeownership and to help them avoid foreclosure and predatory scams.

NCLR is deeply concerned about the lack of progress in restoring stability and ownership opportunities to the housing market. Not only are Latino families losing their homes at record rates, but many that should be able to take advantage of the newly affordable home prices are unable to access credit. Hardworking families from across the country are wondering when they will see the effects of economic relief efforts. The Federal Housing Administration (FHA) mortgage insurance program provides a critical platform through which Congress and the administration can directly help families begin to rebuild their financial future. Nationwide, millions of families are relying on FHA to help them purchase their first home or avoid foreclosure. In fact, in 2008, 45% of Hispanic homebuyers financed their home with an FHA mortgage. While the increase in claim rates against FHA's insurance fund is causing concern, the fact remains that FHA is fulfilling one of its primary roles in the market by stepping in to lend where others will not.

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

FHA has made significant strides in recent years to meet the demand of the market and respond to spikes in unemployment and foreclosures. Still, the program could be strengthened to better serve both borrowers and taxpayers. In my testimony today, I will discuss the impact of changes proposed in the "FHA Reform Act of 2010" on Latino and other underserved communities and provide recommendations on how to further strengthen the program overall.

FEDERAL HOUSING ADMINISTRATION

For more than 70 years, FHA has served low- and moderate-income families, often providing their only affordable loan option. During that time, FHA has repeatedly changed the face of the affordable lending market through its product innovations, such as the 30-year amortizing mortgage and low down payment requirements. While the private market has evolved to offer more affordable products, FHA is unique in its public mission to provide homeownership opportunities to underserved communities. Over the last decade, FHA's share of the market has varied dramatically. In 2001 for example, 35% of all low- to moderate-income homebuyers, and 38% of Latinos had an FHA-insured mortgage. In 2005, that number dropped to 13% of low- to moderate-income homebuyers and 5% of Latino buyers.[2] In the face of a severe credit crunch, lenders in search of security and liquidity returned to FHA insurance. As a result, the FHA reports that its market share shot up to 30% overall in fiscal year 2009 and 45% among Latino borrowers.

The quality of the FHA program and its ability to positively impact local conditions has also been mixed. In the 1990s, FHA came under increased scrutiny and criticism for lax oversight and accountability procedures that allowed unethical lenders to run flipping-refinance scams on vulnerable borrowers and were heavily concentrated in communities of color. Some argued that the lack of oversight also permitted unaffordable mortgages, contributing to FHA's foreclosure rates being higher than conventional loans. As the program lost market share, lenders and industry stakeholders criticized the program's dated technology and processing systems. In high-cost areas, FHA's loan limits were seen as being too low for even the average-priced homes that first-time homebuyers would be seeking.

Underperformance of the FHA program has consequences for the market as a whole. When well executed, FHA has been a benchmark by which lending to underserved communities can be measured. When it is dysfunctional, the baseline disappears. For example, a combination of challenges confronting FHA contributed to its declining market share in the first half of the decade. As the presence and influence of the FHA eroded, subprime lending skyrocketed to 40% of the market and, in many cases, replaced adequate loan products with risky and volatile substitutes. The devastating effect of toxic subprime mortgages on the housing market and broader economy is well known. Communities of color, low-income families, and first-time homebuyers—FHA's target market—have been disproportionately impacted. It is estimated that more than 2.3 million Black and Hispanic households are expected to lose their homes to

[2] Federal Financial Institutions Examination Council, *Home Mortgage Disclosure Act (HMDA) of 1975*, HMDA National Aggregate Report, www.ffiec.gov/hmdaadwebreport/NatAggWelcome.aspx (accessed November 30, 2009).

foreclosure between 2009 and 2012.[3] On the other hand, a strong, flexible FHA loan program can spur market innovation and provide affordable financing alternatives to those of modest means. Underwriting and loss mitigation standards implemented by the FHA program are frequently adopted by other lenders and set the standard for the market.

ECONOMIC RECOVERY THROUGH REVITALIZED HOMEOWNERSHIP OPPORTUNITIES

As the economy continues to struggle and credit remains scarce, all home loan borrowers stand to benefit from a reinvigorated and assertive FHA program. With home prices dipping to new lows, many potential buyers are able to find homes in their price range for the first time. However, few are able to take advantage of the newly affordable home market because they cannot secure financing. This is certainly true for Latino families, many of whom have unique needs that the mainstream market has consistently struggled to meet. For instance, 22% of Latinos do not have enough payment information on file to create a credit score, and one in six does not have traditional banking or savings accounts. Multiple wage-earners and sources of income in a household are also common characteristics of first-time Latino homebuyers. The flexible, prime loans that once accommodated these features have nearly disappeared from the market. Meanwhile, investors with deep pockets have moved quickly to buy homes before local residents are able to get their financing secured, shifting wealth out of neighborhoods and into the hands of absentee landlords.

An effective FHA mortgage insurance program should fill the gaps in the private home loan market through direct participation and by driving innovation in origination and loss mitigation procedures while also remaining fiscally sound. By shoring up local housing markets, the FHA program can directly contribute to the stabilization of the national economy. NCLR is encouraged by FHA's recent progress in meeting the needs of potential homebuyers and homeowners at risk of foreclosure. The recent increase in claims faced by FHA due to mortgage defaults is an invitation to review what more can be done to strengthen the program and its underlying mission to expand homeownership and prevent home losses and, therefore, future claims.

FHA is seeking new legislative authority to make the programmatic changes it believes are necessary to bolster the program's balance sheet, improve its relationships with customers and lenders, and better protect taxpayers. NCLR analyzed FHA's proposal for 1) its impact on the ability of Latino homebuyers to secure affordable credit; 2) the extent to which consumers would be protected against fraud, scams, and predatory lending; and 3) the long-term impact on sustainable homeownership and wealth preservation. Specifically, we found that legislative changes will not likely create any new barriers to affordable credit for low- to moderate-income Latino families, but more can be done to expand homeownership opportunities to underserved communities.

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[3] Center for Responsible Lending, *Projected Foreclosures to Latinos and African Americans by State* (Durham, NC: Center for Responsible Lending, 2009).

Expand Homeownership Opportunities

The legislative and regulatory changes proposed in the "FHA Reform Act of 2010," including an increased down payment for borrowers with a credit score of 580 or below and increased up-front and annual mortgage insurance, are important to the future financial stability of FHA and are likely to have minimal impact on access to mortgages for the Latino community. However, these changes must go hand in hand with flexible lending models, increased efficiency in FHA underwriting, and mortgage discount incentives for borrowers that seek pre-purchase housing counseling.

Successful FHA lending demonstrates how flexible home loans that are underwritten according to borrower affordability can lay the foundation for sustainable homeownership. In particular, low down payment requirements and flexible underwriting criteria, such as the use of nontraditional credit,[4] have allowed millions of families to purchase a home and begin building wealth for their future. However, our NHN housing counselors are reporting difficulty securing such loans. Some lenders are not accepting any form of nontraditional credit, while others have confusing requirements that make their products difficult to use. FHA is experimenting with nontraditional credit by issuing guidance on acceptable forms of nontraditional credit, but lenders add an additional layer of requirements that makes it difficult for housing counselors to prepare borrowers.

In addition, inefficiencies in the FHA underwriting process are not allowing communities affected by the foreclosure crisis to recover quickly. NHN housing counselors report that the FHA underwriting process is taking an extended amount of time, which is affecting homebuyers' chances to purchase Real Estate Owned (REO) properties, homes for sale through short sale, and other properties. These inefficiencies also allow investors instead of first-time homebuyers to snatch up properties.

Finally, NCLR is disappointed that FHA did not take this opportunity to reinstate the pre-purchase housing counseling requirement for first-time homebuyers. In a shortsighted attempt to compete with the subprime market, administrators canceled the counseling requirement to streamline the underwriting process. Families that participate in pre-purchase counseling sessions are less likely to default on their mortgage, preventing foreclosures and future claims.

To effectively serve first-time homebuyers and other vulnerable borrowers, FHA must promote flexible lending models, increase efficiency in underwriting, and maximize its opportunities to reduce risk through homeownership counseling.

[4] Nontraditional credit can be used when a borrower does not have a credit score. A borrower should provide documentation to the lender of timely rental payments for the past 12–24 months, as well as other sources of on-time payments to creditors. Lenders have different requirements for what type of nontraditional credit is acceptable.

More Needs to Be Done to Protect Future Homeowners

NCLR supports the changes proposed in the "FHA Reform Act of 2010," which would boost FHA's ability to police lenders that originate loans with FHA backing. These changes include the expansion of indemnification provisions to all direct endorsement lenders and authority for FHA to withdraw originating and underwriting approval for a lender nationwide based on the performance of its regional branches. However, further improvements to transparency and enforcement in policing of unethical lenders are critical.

Much of the unexpected spikes in delinquencies can be attributed to imprudent or predatory originator behaviors or economic conditions rather than the design of the FHA loan product. According to the FHA's *Annual Management Report: Fiscal Year 2009*, had loans not been made using seller down payment assistance programs, known for being a haven for fraud and abuse, its capital reserve ratio would still be at the recommended 2%. Moreover, anecdotal reports from housing counselors raise concerns that dubious brokers and lenders who once peddled predatory subprime products have turned to FHA as their primary business vehicle.

While we are pleased that FHA has taken steps to make its lender enforcement more accountable through transparency, we are concerned this may not be enough. In an initial review of the Neighborhood Watch Early Warning System, the online tool was difficult to navigate and did not seem user-friendly. That said, we understand that the system is new. We hope to work with HUD to continue to expand and improve the site, including a portal for FHA borrowers to submit complaints and a place for the public to review these complaints.

FHA should provide strong protections for first-time homebuyers by increasing transparency and enforcement. These improvements will help screen out bad actors and give borrowers an opportunity to become first-time homebuyer.

Boost Foreclosure Prevention Efforts to Stabilize Communities

FHA has strong loss mitigation tools that have successfully kept millions of families in their home. However, these services are of little use to a family that does not receive them. While HUD mandates that servicers of FHA loans aggressively pursue loss mitigation, few resources are dedicated to enforcing this provision. Furthermore, because the mandate is not a right afforded to borrowers, and there is no private right of action, individual borrowers who fall through the cracks have no way to defend themselves against foreclosure. HUD has the right to penalize servicers for failure to implement the loss mitigation program, yet NCLR is unaware of any attempts by HUD to exercise its enforcement power.

Newly established loan modification programs, such as Making Home Affordable (MHA), have not changed this dynamic. In fact, a recent survey completed by 13 national HUD-approved housing counseling intermediaries found that 76% of housing counselors rate the knowledge of mortgage servicers of FHA mortgage insurance loss mitigation tools as **fair or poor**.[5] Moreover,

[5] Housing counseling survey conducted by NCLR in January 2010. Actual question: "Rate the performance of mortgage servicers participating in the MHA program on the following services. Knowledge of FHA mortgage insurance loss mitigation tools." **Excellent=1.6%, Good=21.9%, Fair=49.7%, and Poor=26.7%.**

counselors report mortgage servicers are initiating foreclosures prior to evaluating whether a borrower is eligible for MHA.[6]

Furthermore, the fact that claim rates are likely to remain high due to unemployment underscores the need for a broader strategy to prevent foreclosures among families that have experienced a temporary or permanent loss of income. In the cases where foreclosure is unavoidable, more can be done to ease the family's transition back into the rental market.

RECOMMENDATIONS

We applaud FHA for fulfilling the demand for credit in underserved communities. Moreover, NCLR supports the changes proposed in the "FHA Reform Act of 2010" to provide future financial stability to the program. While economic conditions are presenting new challenges to the program, FHA administrators and policymakers cannot allow these pressures to jeopardize FHA's social mission or shy away from deploying its resources as a recovery tool. A dynamic FHA program is critical to stabilizing the housing market and the broader economy. In that spirit, NCLR makes the following recommendations to strengthen the FHA program, restore homeownership opportunities, and protect homeowners and taxpayers:

- **Increase transparency and enforcement in FHA lending.** When lenders originate FHA mortgages, they borrow a brand that is backed by the full faith and credit of the federal government. Given the trust borrowers place on FHA and the exposure of taxpayers, FHA has an obligation to keep its list of eligible originators free of unscrupulous lenders. NCLR recommends that FHA develop a portal for complaints from FHA borrowers. This portal can be added as an enhancement to the existing FHA Neighborhood Watch Early Warning System. Complaints that are submitted should be investigated by FHA staff and made public.

- **Provide incentives to borrowers who seek homeownership counseling, and increase access to flexible lending models.** Congress has invested heavily in creating a solid housing counseling infrastructure. Families that participate in pre-purchase counseling sessions are less likely to default on their mortgage, preventing foreclosures and future claims. NCLR recommends that FHA establish an incentive for borrowers who successfully complete homeownership counseling from a HUD-approved counseling agency before the closing of their mortgage. Incentives can include discounts on the up-front and annual mortgage insurance premiums and a lower down payment requirement. In addition, FHA can increase access to flexible lending products by providing clarification on what documentation is acceptable for nontraditional credit for all lenders so that housing counselors can prepare their borrowers. And finally, to boost the efficiency of the FHA underwriting process, FHA should implement a streamlined system for homebuyers interested in purchasing REO and short-sale properties. This will

[6] Housing counseling survey conducted by NCLR in January 2010. Actual question: "MHA guidelines require servicers to evaluate whether a borrower is eligible for MHA before initiating a foreclosure. In your experience, how consistently is this guideline followed?" **Always=3.1%, Usually=24.9%, Sometimes=28%, Rarely=36.8% and Never=7.3%.**

help get foreclosed homes off the market and to ensure that first-time homebuyers have access to properties before investors.

- **Increase funding for HUD-approved housing counseling agencies.** To ensure that reliable counseling services are available to meet demand, FHA should pay counselors directly for providing advice to FHA borrowers. Also, Congress should increase funding for housing counseling to $100 million, an increase of $13 million from last year, and $180 million for foreclosure prevention counseling, an increase of $67 million, and the original amount of funding that was allocated to address the foreclosure crisis. In addition, NCLR calls on industry leaders to support foreclosure intervention services through funding and partnerships.

- **Make loss mitigation accessible to all FHA borrowers, and enforce its proper use by servicers.** HUD must direct greater resources into ensuring that all servicers are following the FHA servicer guidelines mandating loss mitigation. Servicers should be required to demonstrate that borrowers were ineligible for protocols or programs that could prevent the loss of the home before proceeding to foreclosure and certainly before they could file a claim. Failure to do so should be grounds for reversing a foreclosure and come with strict penalties for servicers. Furthermore, HUD should adopt a zero-tolerance policy and vigorously enforce its mandate and fine violators of the statute. Such duties are included in the "Foreclosure Mandatory Mediation Act of 2010" (H.R. 4635) and Chairwoman Waters's "Foreclosure Prevention and Sound Mortgage Servicing Act of 2009" (H.R. 3451).

CONCLUSION

Hardworking families across the country are wondering when economic relief will find them. While the federal government has a number of tools at its disposal, the FHA program is one that is easier to control and should be maximized to the benefit of all families trying to break into homeownership or keep their wealth and equity from evaporating through foreclosure. For most, homeownership represents the bulk of household assets that will help families move more firmly into the middle class. A strong, competitive FHA program should support this goal, especially during a credit crunch. As private capital begins to flow again, FHA should serve as a benchmark for service to low- and moderate-income borrowers, borrowers of color, and others unable to access traditional credit.

Testimony of Dr. Andrew Caplin

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Before the House Committee on Financial Services

Subcommittee on Housing and Community Opportunity

For the Hearing On

"The FHA Reform Act of 2010"

March 11, 2010

EXECUTIVE SUMMARY

The Federal Housing Authority (FHA) has long served a pivotal role in expanding housing affordability. However, continuation of its tradition of good works is currently being placed at risk. With all due respect, I cannot agree with Commissioner Stevens' view that it would take a "catastrophic" fall in house prices for FHA to require a taxpayer-funded bailout (HUD [2009] p.1). Recent research (Aragon et al. [2010]), appended to this testimony, indicates that the actuarial review presented to Congress (Integrated Financial Engineering [2009]) understates FHA risk. We cannot measure the full extent of this understatement without greater access to FHA data. In the meantime, literally no one knows the level of FHA risk.

The problems in the actuarial review first came to our attention when Joseph Tracy, Executive Vice President and Senior Advisor to the President of the Federal Reserve Bank of New York, noticed that FHA prepayment behavior changed radically in 2009. Many mortgages that were significantly under water, which traditionally do not prepay, suddenly started to prepay. It is as if a group of particularly sick patients at a hospital suddenly appeared cured. As is so often the case, if it seems too good to be true, it is.

Joe and I were able to discover the cause of this apparent miracle cure, which turns out to be poor record keeping when one FHA mortgage is "streamline-refinanced" into another. To use the hospital analogy, it is as if very sick patients had been moved to a new room for treatment, yet were recorded as having been cured and discharged from the hospital. The room down the hall then took no new measurements, disregarded information from the prior treatment, and treated the patient arriving from the neighboring ward as relatively healthy. With this form of record-keeping, a hospital could boost its apparent success rate by moving patients frequently between rooms. Unfortunately, FHA did just this in its record-keeping, as a result overestimating FHA's success rate.

To be clear, it is the failure to keep track of streamline refinances that is objectionable. Indeed we ourselves proposed such a program to protect borrowers' ability to refinance against falls in house value (Caplin, Freeman, and Tracy [1997]).

The actuarial review has many other shortcomings detailed in the written testimony and our paper, of which I list but two:

- **Delinquency and Modifications are ignored:** The review analyzes only final claims to the FHA's Mutual Mortgage Insurance fund and ignores information about future claims that is contained in current delinquency rates. It also ignores mortgage modifications, including "partial claims", which are costly, increasingly prevalent, and of unknown efficacy. This would be analogous to tracking a disease by monitoring mortality rates, while ignoring information on rates of initial infection, hospitalization, and post-intervention outcomes.

- **Unemployment is inadequately captured:** Highly under-water FHA mortgages are disproportionately located in areas that are experiencing even more unemployment stress than the national average. This is not properly captured in the actuarial review.

The actuarial review has a recent history of over-optimism: the 2009 review began with a litany of reasons that the 2008 review had under-estimated losses. Given the above, there is every reason to expect the same to occur in 2010.

I close with three concrete proposals.

1. It is currently impossible to comment on FHA reform proposals, since their impact on FHA risk cannot be accurately estimated. FHA should immediately work to correct the identified problems and amend its risk assessment methodology.

2. FHA should expand access to its books in the spirit of transparency. The best way to keep FHA risk analysis at the frontier is to open up access to the data to outside researchers. This is also a way to leverage the existing budget that the FHA has to conduct its risk analysis.

3. Joe Tracy and I coauthored a book called "Housing Partnerships" that detailed reasons for introducing equity into the housing finance market some 12 years ago now. The book was subtitled: "A New Approach to a Market at a Crossroads." Unfortunately, the wrong turn was taken. Rather than introducing equity capital that would involve sharing of risk, recent innovations in housing finance instead acted to increase leverage. This approach has come to a dead-end. It is time finally to go back to the fork in the road and to introduce markets in housing equity as a far safer method of raising housing affordability. The U.S. Federal Government has a positive track record of encouraging innovation in housing finance dating back to the Great Depression, and now is the perfect time to build on that record.

THE RECENT RISK ASSESSMENT

FHA is mandated to conduct an actuarial review on an annual basis and simultaneously to report to Congress. The most recent report (Integrated Financial Engineering [2009]) indicates that there will likely be no need for a taxpayer funded bailout. This analysis supports the conclusion of Commissioner Stevens as expressed to the Subcommittee on Housing and Community Opportunity U.S. House Committee on Financial Services of October 8, 2009:

"Let me simply state at the outset that based on current projections, absent any catastrophic home price decline, FHA will not need to ask Congress and the American taxpayer for extraordinary assistance – we will not need a bailout." (HUD [2009] p.1)

To the extent that the above assessment is based on IFE [2009], there are clear reasons for worry. The most recent report details the extent to which the 2008 review underestimated the ensuing losses on all prior FHA books of business (IFE [2009], p.27). This makes one curious as to the robustness of the methodology and the thoroughness of the risk assessment. Further worry is caused by a first look at the IFE methodology, which is entirely at the loan level. Researchers Diego Aragon and Joseph Tracy of FRBNY had been studying prepayment and default behavior of FHA mortgages and noticed that the prepayment model started to go very wrong in 2009. This result surprised them since there had been no mention in the actuarial review of any problems in estimating their models.

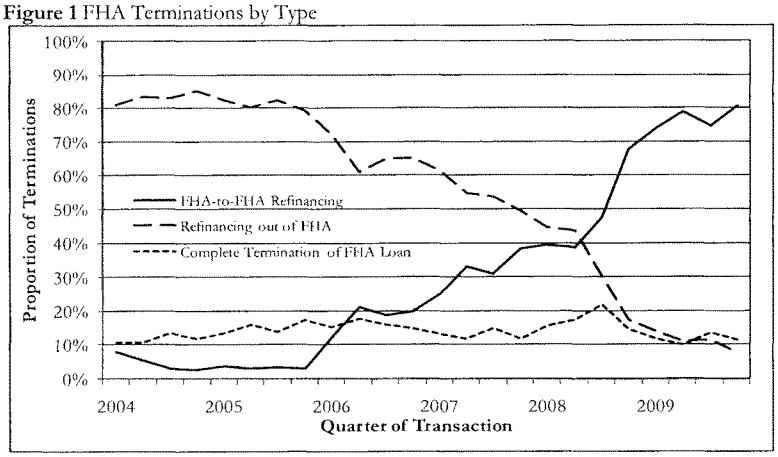
At the same time that the researchers at FRBNY noted the failure of their prepayment model, I was participating with a group of collaborators in economics and computer science at NYU on methods for improving house valuation. First American CoreLogic (FACL) put together a unique for property-level data set for LA County that aggregates liens to the house level. To our knowledge, there is no other property-level data set that contains information on mortgages by type, including whether or not loans are FHA insured. As long time collaborators and friends, Joseph Tracy and I quickly spotted that our LA data may be useful in advancing the analysis of FHA mortgages beyond the loan-level, and therefore beyond the level of the actuarial review. We were more right than we could have known. We quickly identified the cause of the instability of loan-level prepayment estimates was a radical change in the pattern of mortgage terminations. This change was not correctly accounted for in the actuarial review, which caused fundamental, and to this day uncorrected, errors in risk assessment.

SHORTCOMINGS OF THE ACTUARIAL REVIEW: THE ARAGON ET AL. PAPER

In the early 2000's, FHA loans typically terminated when the borrower sold the house and moved, or took out a new loan from a competitor on superior terms. Both forms of prepayment entirely removed the risk from the FHA books. Yet in 2009, terminations were dominated by "streamline

refinances," which involve no new underwriting and in which the risk stays with FHA.[1] Figure 1 illustrates the changing pattern of mortgage terminations in LA County.

Figure 1 FHA Terminations by Type



Note: Aragon et al. 2010.

We are not against the streamline refinance program: indeed we ourselves proposed such a program to protect a borrower's ability to refinance against falls in house value (Caplin, Freeman, and Tracy [1997]). While it may be good policy to allow these high LTV mortgages to refinance to a lower interest rate given that the FHA already owns the credit risk, it is important that the audit analysis properly distinguish between these loan modifications and other prepayments of FHA mortgages. A streamline refinance is not the same as a termination that removes all risk from the FHA books. Unfortunately the original FHA mortgages that undergo a streamline refinance are treated in the audit analysis no differently than FHA mortgages that in fact pay off and represent no further credit risk to the FHA.

I want to emphasize what a fundamental error it is to model a streamline refinance as equivalent to a permanent exit from FHA, and how profoundly it compromises the actuarial review. The competing risk model used to simulate future losses allows for a three way classification of FHA-insured mortgages at any point in time: a "Bad" group that terminate with a claim on the MMI Fund; a "Good" group that terminate without such a claim; and an "Ongoing" group that may in future end up either in the "Bad or "Good" group. Including streamline refinances in the "Good" group, as the

[1] Like the HARP program for GSE mortgages, the streamline refinance program is designed to allow high loan-to-value (LTV) FHA mortgages to refinance to a lower interest rate when they otherwise would not qualify for a refinance. In a streamline refinance, an existing FHA mortgage is refinanced into another FHA mortgage. No new underwriting is undertaken for these refinances. To qualify, a borrower must be current in all payments and is not allowed to take cash out. Part of the mortgage insurance fee for the former FHA mortgage is refunded to the borrower (see http://www.fha.com/refinance.cfm.)

actuarial review does, artificially inflates the size of this group, and affects the coefficient estimates that are used to predict the probabilities that mortgages in the Ongoing group will terminate in the "Good" group in the future.

To use the hospital analogy, it is as if very sick patients had been moved to a new room for treatment, yet were recorded as having been cured and discharged from the hospital. The room down the hall then took no new measurements, disregarded information from the prior treatment, and treated the patient arriving from the neighboring ward as relatively healthy. With this form of record-keeping, a hospital could boost its apparent success rate by moving patients frequently between rooms. Unfortunately, FHA did just this in its record-keeping, as a result overestimating FHA's success rate.

The inappropriate treatment of streamline refinancing is but one part of a larger problem with model specification. A simple model with two competing terminal risks is inadequate to the task of modeling FHA risk in a world in which there are so many intermediate events. In addition to streamline refinancing, a robust model of FHA risk would take account also of the various stages of mortgage delinquency, other forms of mortgage modifications (such as "partial claims"), and other events that cannot be classified either as "Good" or "Bad" terminations, yet are profoundly informational.

Misclassification of streamline refinances not only compromises the loss model, but also results in underestimation of underwater mortgages (those with LTV above 100%). The recent audit report incorrectly records the initial LTV on new mortgages that result from a streamline refinance ignoring changes in house values since issuance, which have typically been negative, often significantly so. The difference this makes is dramatic. Applying the methodology used in the actuarial review to nationwide data indicates that only 1.5% of streamline refinanced mortgages in 2009 started out with negative equity. Yet, when we use the FHFA price indices, some 33.4% of streamline refinances involved mortgages with negative equity. With all other house price indices, the proportion in negative equity is even higher.

The impact of house valuation on LTV estimates is a particular concern of the NYU team, which has been researching index-based errors for some years. There is no justification in the actuarial review for the use of the FHFA index: in our limited sample from LA County we find this index to significantly underestimate declines in house values. In contrast, he actuarial review includes no analysis whatever of these errors. This is clearly an area in which the risk assessment needs to be beefed up. So too are estimates of house price volatility around the index. Again, our LA County data suggest that this volatility, which increases losses to the FHA insurance fund, is significantly underestimated. The actuarial review is entirely silent on this subject.

Aragon et al. [2010] note a number of omissions from the FHA risk assessment:

- **Delinquency is ignored:** The review analyzes only final claims to the FHA's Mutual Mortgage Insurance fund and ignores information about future claims that is contained in current delinquency rates. This would be analogous to tracking a disease by monitoring mortality rates, while ignoring information on rates of initial infection, hospitalization, and post-intervention outcomes.

- **Modifications and "Partial Claims" are ignored:** Mortgage modifications, including "partial claims" are increasingly prevalent, yet they are not incorporated in the risk analysis. Nor is anything said about how cost effective these strategies are in relation to available alternatives. Haughwout *et al* [2009] demonstrate that reducing the monthly payment by cutting principal is much more effective at lowering the post modification default rate than an equivalent reduction in the monthly payment achieved by cutting the interest rate and extending the term. There should also be consideration given to equity sharing methods, in which equity is exchanged for debt, both to reduce the need for an immediate write-down, and to allow FHA to benefit from any later appreciation there might be.

- **Unemployment is inadequately captured:** The FHA portfolio of mortgages is being exposed to a rapidly rising risk of income shocks from job loss. Moreover highly under-water FHA mortgages are disproportionately located in MSAs that are experiencing relatively more unemployment stress than the national average. The loan level risk analysis in which unemployment is recorded as insignificant needs to be supplemented by aggregate risk analysis that properly captures the relationship between unemployment and default.

- **The Worst Case House Price Scenario is Optimistic and Unsupported:** The worst case "stress test" analysis in the actuarial review involves house prices rising continuously from 2011 and on. It is hard to see how this is appropriate as a worst case event for a mono-line insurer such as FHA. House prices are random, and are never "certain" to increase in future, especially as a worst case. In fact, there are many reasons for concern going forward, including the large shadow inventory of houses in process of foreclosure, the fragility of private sector mortgage lending, and the weaknesses in the commercial real estate sector.

CONCLUDING REMARKS

I make three concrete proposals by way of conclusion.

1. FHA should immediately work to correct the identified problems and amend its risk assessment methodology. It is currently impossible to comment on FHA reform proposals, since their impact on FHA risk cannot be accurately estimated.

2. FHA should expand access to its books in the spirit of transparency. The best way to keep FHA risk analysis at the frontier is to open up access to the data to outside researchers. This is also a way to leverage the existing budget that the FHA has to conduct its risk analysis. It will also enable risks to taxpayers and to borrowers to be assessed and reduced to the necessary minimum.

3. FHA should set up a parallel work track to identify durable solutions to problems of housing affordability that are less risky than the methods relied on to date. Together with Sewin Chan of NYU and Charles Freeman, now of Citibank, Joe Tracy and I coauthored a book called "Housing Partnerships" some 12 years ago now. The book detailed reasons for introducing equity into the housing finance market. It was subtitled: "A New Approach to a Market at a Crossroads." Unfortunately, the wrong turn was taken. Rather than introducing equity capital that would incentivize sharing of risk and therefore accurate risk assessment, recent innovations

in housing finance instead acted to increase leverage. This approach has come to a dead-end. It is time finally to go back to the fork in the road and to introduce markets in housing equity as a far safer method of raising housing affordability. The U.S. Federal Government has a positive track record of encouraging innovation in housing finance dating back to the Great Depression, and now is the perfect time to build on that record.

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Testimony of John A. Courson

President and Chief Executive Officer

Mortgage Bankers Association

Before the

House Financial Services Subcommittee on

Housing and Community Opportunity

Hearing on

"The FHA Reform Act of 2010"

March 11, 2010

Chairwoman Waters, Ranking Member Capito and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)[1] on the proposed FHA Reform Act of 2010. I am John Courson, President and Chief Executive Officer of MBA. I was engaged in the mortgage banking industry, and an FHA approved lender, for over 40 years and was MBA Chairman in 2003.

The Federal Housing Administration (FHA) is especially important to segments of the population who need a little extra help to achieve the American dream of homeownership. More than any other nationally available program, FHA focuses on the needs of first-time, minority, and low- and moderate- income borrowers. According to recent data provided by the Department of Housing and Urban Development (HUD), both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. As of January 2010, approximately 81 percent of FHA-insured home purchase loans were made to first-time homebuyers, and 32 percent of these first-time loans were made to minorities. Minorities also comprise a higher percentage of the FHA market than the conventional mortgage market.

MBA has always been a proponent for a strong and vibrant FHA. We called for updates and enhancements to FHA's risk management, scope and operations well before the current market disruptions reestablished FHA's prominence as a catalyst for bringing liquidity to the housing finance system. MBA believes FHA's dramatic growth and corresponding need to keep the Mutual Mortgage Insurance Fund ("MMI Fund") solvent make it imperative that we act swift and appropriate measures to preserve the agency's strength and viability now and over the longer term. Protecting and improving FHA requires a multifaceted approach: ensuring that FHA has the right resources; requiring appropriate eligibility standards for lenders; creating credit policies that are both prudent and aligned with FHA's mission; and ensuring that FHA is providing market liquidity during times of crisis.

When MBA last testified before the House Financial Services Committee, FHA had recently released its Actuarial Report. The report showed that the capital reserve account of the MMI Fund had fallen well below the statutory target of two percent. In fact, it had fallen dramatically from three percent in 2008 to just 0.53 percent in 2009. The announced shortfall in the capital reserve account was a major wake-up call for FHA and the lending community but not a reason to panic. The two percent target was established by Congress to ensure that FHA could withstand the stress of a major housing and mortgage market downturn, an event like the one experienced by the

[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.

industry over the past two years. In response to the decrease in the reserve account, HUD and FHA leadership have been taking proactive measures in order to ensure that a taxpayer "bailout" will not be necessary.

These measures include a series of policy changes that address risk management – changes designed to strengthen FHA's capital reserves. Announced by FHA on January 20, 2010, these policy changes fall into three categories: 1) legislative; 2) regulatory; and 3) operational.

The legislative changes, which require congressional action, include:

- Increasing the statutory cap on the annual mortgage insurance premium (MIP). In concert with the increase, the upfront and annual premium structure will be adjusted, with some of the upfront premium being shifted to the annual premium.
- Amending the National Housing Act to apply indemnification provisions to all Direct Endorsement (DE) lenders.
- Granting HUD the flexibility to establish separate "areas" for review and termination under the Credit Watch initiative. With this authority, FHA could withdraw a lender's nationwide approval on the basis of the performance of one or more of its regional branches.

The regulatory changes, which would be implemented through a notice and comment rulemaking, include:

- Requiring a 10 percent downpayment for loans to borrowers with a credit score of 579 or lower.
- Reducing allowable seller concessions from six percent to three percent.
- Implementing statutory authority to enforce indemnification provisions for lenders using delegated insuring process.

The operational changes, which FHA can implement on its own or through Mortgagee Letters, include:

- Raising the upfront mortgage insurance premium by 50 basis points to 2.25 percent – this change goes into effect April 5, 2010.
- Enhancing the monitoring of lender performance and compliance with FHA guidelines and standards – FHA has begun implementation.
- Publicly reporting lender performance rankings – FHA has begun implementation.

MBA supports many of these regulatory and operational changes, such as increasing the downpayment requirement for borrowers with credit scores below 580, raising the upfront MIP, and enhancing the monitoring of lender performance and compliance with FHA guidelines and standards. We also support increasing the annual premiums, to be implemented with a reduction of the upfront premium.

We have concerns, however, about some of FHA's other proposed changes, such as expanding indemnification to include all DE lenders, the authority to withdraw approval for a lender's nationwide operations on the basis of the lender's performance at a regional branch, and reducing allowable seller concessions.

MBA offers the following remarks with respect to the policy changes this subcommittee requested that we specifically address.

FHA Proposed Legislative Changes

Increase in the Annual Mortgage Insurance Premiums

MBA supports a reasonable increase in the annual mortgage insurance premiums. On April 5, 2010, the upfront MIP will increase from 1.75 percent of the loan amount to 2.25 percent – the statutory maximum – for most FHA mortgages (the Home Equity Conversion Mortgages and HOPE for Homeowners programs are notable exceptions). HUD is asking Congress to increase by statute the maximum annual premium FHA is authorized to charge from 0.55 percent to 1.55 percent. If this legislative change is enacted, FHA plans to lower the upfront premium and increase the annual premium. This shift will allow for an increase to the capital reserve with a lower up-front cost to the consumer. MBA supports this request and its plan for implementation.

Indemnification Changes for Direct Endorsement Lenders

MBA supports high standards for all lenders that participate in the FHA programs in order to protect the viability of FHA, the lender's reputation, and the reputation of the industry. HUD is proposing to extend the Secretary's authority to require indemnification by lenders to include all Direct Endorsement lenders, not just those that participate in the Lender Insurance (LI) program.

FHA-insured single family mortgages are originated and underwritten through the DE process, which allows an FHA-approved DE lender to underwrite mortgage loans, determine their eligibility for insurance, and submit them directly for insurance endorsement without FHA's prior review. High-performing DE lenders with acceptable default and claim rates may apply to be approved to participate in the LI program, which enables these lenders to endorse FHA mortgage loans for insurance without a pre-endorsement review by FHA.

From February 1, 2009, through February 1, 2010, there were approximately 2,024 active DE lenders; 596 of these lenders were also approved for participation in the LI Program. As of January 2010, approximately 71 percent of FHA loan volume was endorsed through the LI process. Expanding this section of the National Housing Act to include DE lenders would impact approximately 1,428 lenders.

Under the statutory authority of section 256(c) of the National Housing Act, the HUD Secretary can require indemnification (the lender agreeing to assume the risk of what may be an anticipated loss by FHA) of a loan through the LI program if the loan was not originated or underwritten in accordance with requirements established by HUD. If fraud or misrepresentation was involved in connection with the origination or underwriting, HUD may require these lenders to indemnify HUD for the loss regardless of when an insurance claim is paid. This existing authority only applies to indemnification by LI lenders and currently does not include DE lenders that are not participants in the LI program. For loans not originated under the LI program, HUD may request, but not require, indemnification by the mortgagee. It is important to note that all FHA loans are subject to indemnification by any DE lender – participating in the LI program or not – in the event of lender fraud or material misrepresentation.

Lenders participating in the LI program are able to endorse FHA mortgage loans without a pre-endorsement review by FHA. These lenders are willing to accept the additional risk of indemnification in the event they fail to originate or underwrite a loan in accordance with HUD's requirements. In contrast, all of the FHA loans originated by DE lenders not in the LI program undergo a pre-endorsement review by FHA prior to the issuance of the insurance certificate.

Indemnification is a very serious issue. Lenders incorporate sophisticated quality control systems to minimize their exposure to these liabilities. By extending this additional responsibility onto DE lenders, FHA will cause responsible lenders to become even more cautious in underwriting loans. FHA's action would run counter to its mission by reducing the availability of affordable housing credit. MBA members recognize and accept accountability for instances of fraud and negligence within their control. They are concerned, however, about the layering of additional risk management requirements that significantly increase compliance costs and lead to fewer responsible borrowers qualifying for FHA loans.

Establishing "areas" for purposes of Review under the Credit Watch Initiative

FHA is also seeking a legislative change that would give the agency maximum flexibility to establish separate "areas" for purposes of review and termination under the Credit Watch initiative. This change would provide authority to withdraw originating and underwriting approval for a lender nationwide on the basis of the performance of its regional branches.

FHA should be fully empowered to enforce its guidelines, including taking swift action to sanction remediation against violations commensurate with their level of severity. Moreover, we understand that particularly egregious abuses may merit sanctions against a lender beyond the regional level.

MBA wants to work with FHA to develop fair and transparent processes and procedures for determining the grounds for triggering a nationwide action against a lender. We urge

Congress to require that the policy include well-defined and incremental enforcement standards so that lenders have ample opportunity to rectify any regional concerns within their field office before FHA imposes a national sanction. National lenders should be afforded the ability to demonstrate the actions they implemented before HUD takes more drastic action.

Other Comments

Reducing Seller Concessions

FHA is proposing to reduce the current maximum seller concession from six percent to three percent. This change will make FHA's standards consistent with Fannie Mae and Freddie Mac's seller concession policies. MBA plans to comment on this proposed regulatory change thoroughly during the public comment period.

For the purposes of this hearing, we would like to point out that the reduction in seller concessions will primarily impact low-to-moderate, first-time, and minority homebuyers. Seller concessions are usually used to pay for borrowers' closing costs and make buying a home more affordable. We are concerned that this could be another policy change that would have an adverse effect on the population that traditionally has sought FHA's assistance to purchase a home. We believe it is important to carefully balance FHA's risk management obligations with its duty to pursue its affordable housing mission and support the housing recovery.

Changing FHA Downpayment Requirements

There has been much discussion among policymakers and the industry about whether FHA should increase its minimum 3.5 percent downpayment requirement. One of the changes FHA recently proposed is to raise the minimum downpayment to ten percent for borrowers whose credit scores are lower than 580. MBA supports that change. We do not, however, believe that the minimum downpayment should be raised for all FHA borrowers. Although well intentioned, there are better ways to reduce risks to FHA.

With lenders requiring higher downpayments and private mortgage insurance being unavailable in many cases, FHA is more important to the market today than ever. Increasing the downpayment requirement will greatly reduce the availability of credit at a time when we are just beginning to see signs of economic recovery.

Other actions, such as a updating of the TOTAL Scorecard and changes to premium levels, are alternative ways to manage risk. We should allow ample time to test those policy changes before enacting an across-the-board downpayment increase.

TOTAL Scorecard

As FHA is assessing all of its risk management tools and polices, we strongly encourage the agency to examine the FHA TOTAL Scorecard in order to improve its reliability, and functionality. MBA believes the time is right to reevaluate whether the current scorecard is the right technology for promoting sustainable homeownership. In particular, such an evaluation should review the thoroughness of the scorecard's borrower risk assessment capabilities.

Resources Necessary for Improved FHA Operations

MBA believes a critical requirement for achieving, sustaining and protecting the housing market's long-term vigor is ensuring that FHA has the resources it needs to operate in a modern, high-tech real estate finance industry. FHA's staff levels have remained virtually unchanged in recent years, even though its market share has risen from three percent to over 30 percent. This ratio of activity to resources is unsustainable, because it stretches FHA beyond its capacity. MBA strongly supports H.R. 3146, the 21st Century FHA Housing Act, which would provide FHA with up to $72 million in funding to hire additional staff and upgrade its compensation levels so they would be commensurate with those at other federal financial regulators. The bill also permits funding to upgrade technology. Modern technology would enable FHA to better monitor lenders, protect against fraud, and generally be better equipped to handle the challenges of a modern marketplace.

MBA is grateful that, under the Housing and Economic Recovery Act of 2008 (HERA), Congress authorized $25 million to be allocated each year from FY 2009 through 2013 to provide FHA with improved technology and processes and to help reduce mortgage fraud. The Omnibus Appropriations Act of 2009[2] made $4 million available for FY 2009 and FY 2010 to be used "for planning, modernizing, improving and maintaining information technology applications and infrastructure supporting FHA." While this funding is appreciated, it is not nearly enough to address FHA's growing needs. We urge Congress to provide the full $25 million each fiscal year though 2013, as authorized under HERA. Furthermore, as in H.R. 3146, FHA should be given the statutory authority to use its future revenues to make technology upgrades as needed. Ensuring these resources are available to FHA not only helps support the viability of its products and services, but it also helps protect the MMI Fund and the American taxpayer.

FHA Multifamily Programs

MBA would like to commend the House for passing H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act, in September 2009. While FHA's multifamily loan limits are

[2] Pub. L. 111-8 (March 10, 2009).

sufficiently high in most markets, in some areas of the country they are severely restricting the ability to use FHA insurance programs to finance rental housing. H.R. 3527 will increase the loan limits for elevator buildings and provide the HUD Secretary with additional discretion in extremely high cost areas (similar to that provided in Alaska and Hawaii today).

As is the case on the residential side, FHA's multifamily programs are experiencing heightened demand during the economic downturn. Until other traditional sources of capital return, FHA will continue to see growth in its share of the multifamily market. MBA looks forward to continuing our productive conversations with FHA on issues of mutual interest, and we look forward to continuing to work with FHA to promote prudent lending decisions that will preserve the MF Insurance Fund.

Conclusion

MBA appreciates that FHA is performing the countercyclical role for which it was created by ensuring a stable, liquid and affordable source of housing finance during this difficult time in the housing market. We look forward to working with FHA and Congress to strike a balance between prudent risk management practices and providing assistance to qualified borrowers. Thank you again for the opportunity to share MBA's views.

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HEARING BEFORE THE

UNITED STATE HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"THE FHA REFORM ACT OF 2010"

WRITTEN TESTIMONY OF

CHARLES MCMILLAN, CIPS, GRI

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

MARCH 11, 2010

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EQUAL HOUSING OPPORTUNITY

Madam Chairwoman, Ranking Member Capito, and members of the Subcommittee, my name is Charles McMillan, and I am the immediate Past President of the National Association of REALTORS®. I have been a REALTOR® for more than 20 years, and am Director of Realty Relations and Broker of Record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth. Along with being a REALTOR®, I have been active in my community, serving as past chairman of the Community Development Council of Fort Worth, the Tarrant County Affordable Housing Task Force, the Housing Subcommittee of Fort Worth, and a past director of the United Way of Tarrant County and of the Fort Worth Chamber of Commerce.

I am here to testify on behalf of 1.2 million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on the importance of the Federal Housing Administration (FHA) mortgage insurance program. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

FHA was created in 1934, and since then has provided more than 37 million American homeowners with safe, stable, financing in all markets. FHA is not a subprime lender, has strong underwriting criteria to protect American taxpayers, and has never required a federal bailout. FHA borrowers are not subsidized, and pay both upfront and annual premiums. While the program is experiencing shortfalls in its excess reserves due to our economic crisis, FHA remains financially strong and a critical part of our nation's economic recovery. Without FHA, our economy could not be on the verge of recovery.

In fact, the dramatic increase in FHA's market share demonstrates how critical the program is to our nation's economic recovery. In 2009, FHA insured nearly 30 percent of the single family mortgage market, compared to a low of nearly 3 percent just three years ago. In 2009 more than 50 percent of first-time buyers used FHA; and nearly 80 percent of FHA's purchase loans were to first-time homebuyers. In addition, FHA is serving a need for those who need to refinance out of risky nontraditional ARMs or subprime loans with high interest rates. In 2009, approximately 835,000 borrowers refinanced into lower interest rate FHA insured loans, saving them an estimated $1.3 billion.

It can be argued that FHA's market share is a good indicator of the state of housing markets. Back when FHA was at 3 percent of the market, that should have been a warning sign that we were in a troubled mortgage market, with abusive lenders wooing homebuyers away from safer, stable mortgage products. Now, with FHA at nearly 1/3 of the market, it is clear that the private market has yet to rebound. Historically, FHA's market share has hovered between 10 and 15 percent of the market. We believe this is an appropriate share for the FHA program. FHA was created to serve the needs of all homebuyers who lacked access to mortgage financing. However, the private market should be the primary source of mortgage financing. Today, that market is extremely limited, so FHA is meeting its role to fill that gap. When the private market is strong enough to return, we will welcome FHA's reduction in market share, as that will indicate a return to a healthy housing market.

FHA 2009 Audit

We have testified previously before this committee about the reasons that the FHA audit showed reserves had fallen below the 2% capitalization ratio. We believe the bulk of FHA's excess reserves loss can be explained in large part by the unprecedented declines in housing prices coupled with rising unemployment that this nation has experienced in the last few years. Many borrowers are underwater on the value of their homes, and many families have members that have lost jobs. These two factors lead to increased defaults. No level of underwriting standards or equity requirements could have avoided that. As a Congressional Research Service (CRS) report, published November 23, 2009, stated "FHA would not be able to prevent defaults arising from deteriorating financial and macroeconomic conditions."[1]

FHA has continued to require prudent underwriting and has sufficient controls against risk. In fact the FHA reserves requirement is by far greater than any requirement placed on private banks or lenders. FHA's fully capitalized cash reserves account for paying all claims over a 30 year period. By comparison, the Financial Accounting Standards Board only requires financial institutions to hold reserves for losses over the next 12 months. FHA has 30 times that amount in their cash reserves, with another $2.7 billion in the excess capital reserves. We do not dispute the findings that the reserves have fallen, but believe FHA has sufficient reserves to cover losses, and sufficient controls in place to control risk.

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[1] CRS Report R40937, *The Federal Housing Administration (FHA) and Risky Lending*, coordinated by Darryl E. Getter.

Since being confirmed, FHA Commissioner Dave Stevens has instituted changes to ensure that FHA remains safe and sound and serves the needs of its borrowers without burdening American taxpayers. For the first time in the history of FHA, Commissioner Stevens hired a Chief Risk Officer to oversee FHA's efforts to mitigate risk. He has also taken action against abusive and unscrupulous lenders. In 2009, more than 590 cases were brought before FHA's Mortgagee Review Board – which is more than was brought in the previous 8 years combined. FHA terminated FHA approval of 268 lenders in 2009 – compared to 101 in the previous 8 years combined. We believe FHA's management is committed to increasing oversight and dealing with abusive lenders.

Today, FHA borrowers' credit profile has never been stronger. The Federal Reserve report shows that FHA is not the new subprime lender - its FICO scores have increased, and its Loan-to-Value ratios (LTVs) have decreased. The average credit score for FHA's current customer has grown to 693, and only 13 percent of their purchase borrowers this year had FICO scores below 620. Forty four percent of FY2009 loans have FICO scores above 680, and 30 percent had scores above 720. And those numbers are only improving, according to HUD's recent Report to Congress. In September of this year 45 percent of FHA loans had FICO scores above 700, and less than 5 percent had scores below 620. Borrowers also have more equity, as the percentage of FHA's LTV ratios above 95 percent fell from 72 percent in 2007 to 62 percent in 2008. In fact, the audit shows a record $4.9 billion positive adjustment due to the high credit quality of FHA's recent originations.

FHA's New Initiatives

In an effort to replenish the capital reserves, FHA has implemented (or proposed) a number of changes to the program. While we are not convinced that all of these changes are necessary, we generally support FHA's efforts to strengthen the program. We urge caution in making changes that will make it hard for credit-worthy borrowers to become homeowners.

Mortgage Insurance Premiums

FHA has increased the upfront mortgage insurance premium (UFMIP) to 2.25 percent up from 1.75 percent. In addition, FHA will seek legislative authority to increase the annual premium (currently capped at 0.55 percent). Increasing the upfront premium dramatically increases closing costs for borrowers. The average closing costs to borrowers can range anywhere between 3 and 6 percent of the loan. This increase of 0.50 percent places a high burden on FHA borrowers. Homebuyers are already facing increased fees from appraisals and other closing services. Increasing the upfront premium for FHA loans just adds to this problem.

We understand that FHA intends to lower the upfront premium when it is granted authority to increase the annual premium. We support legislation to reasonably increase the annual premium in order to replenish FHA's capital reserves. We also strongly support decreasing the upfront premium to help borrowers at the closing table. In addition, we would urge the Department to use discretion to insure borrowers are not paying too high a fee. Years ago, FHA had a distributive shares program that provided rebates to FHA borrowers who paid excess fees into the MMIF. While we are not asking to reinstate this program at this time, we encourage FHA to monitor MMIF level and premium levels, and adjust them – both up and down, appropriately.

Credit Score Changes

FHA has proposed that borrowers with a credit score below 580 be required to make at least a 10 percent down payment. The minimum down payment will remain at 3.5 percent for all other borrowers. FHA's mission is to serve those underserved by the private market. The National Association of REALTORS® does not condone making loans to borrowers who are unable to repay the loan, or are at significant risk to not repay the loan. However, we do not believe that credit scores are a perfect indicator of risk. And in fact, credit scores have a disparate impact on minorities over other borrowers.

A Federal Reserve study completed in 2007 found that "different demographic groups have substantially different credit scores, on average. For example, on average, blacks and Hispanics have lower credit scores than non-Hispanic whites and Asians, and individuals younger than age 30 have lower credit scores than older individuals. Also, for given credit scores, credit outcomes—including measures of loan performance, availability, and affordability—differ for different demographic groups."[2] A Federal Trade Commission report in the same year found that "non-Hispanic whites and Asians are distributed relatively evenly over the range of scores, while African Americans and Hispanics are substantially overrepresented among consumers with the lowest scores (the scores associated with the highest predicted risk) and substantially under-represented among those with the highest scores."[3] The disparate impact

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[2] *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit,* Board of Governors of the Federal Reserve System, August 2007.

[3] *Credit-Based Insurance Scores: Impacts On Consumers Of Automobile Insurance,* A Report to Congress by the Federal Trade Commission, July 2007.

of credit scores on minority groups flies in the face of the mission of FHA to serve underserved markets.

Seller Concessions

FHA intends to propose a rule to decrease seller-paid concessions to 3 percent from 6 percent. FHA requires borrowers to provide a cash downpayment of 3.5%. The LTV on an FHA purchase loan cannot be more than 96.5%. So even with seller concessions, borrowers still have "skin in the game." Closing costs for loans differ greatly from state to state, irrespective of housing costs. Texas is surprisingly the state with the highest closing costs, followed by New York, and then Florida[4]. In states where closing costs are high, our members report that seller concessions are often higher than 3%, and are critical to allowing the borrowers to purchase the home without depleting all of their savings.

Lender Enforcement

FHA is proposing a number of changes to facilitate stronger oversight over FHA lenders and further protection for the Mutual Mortgage Insurance Fund (MMIF) and American taxpayers. To date, FHA Commissioner Stevens has shown a commitment to eliminating problematic lenders and taking all necessary enforcement measures to insure the safety and soundness of FHA and protection of borrowers.

As was discussed earlier, FHA is taking serious steps to assure FHA lenders are not abusing the program. They have stepped up oversight and enforcement, removing approval of or suspending 274 lenders in 2009. We applaud the efforts of Commissioner Stevens in this area, and support adding more tools to FHA's arsenal to protect FHA borrowers and taxpayers.

Other FHA Issues

Some members of Congress have introduced legislative proposals that react hastily and, we believe inappropriately to FHA's audit findings. We urge Congress to exercise caution before considering proposals that may have a profound adverse impact on our economic recovery and diminish programs that serve such a critical role to our nation's families. Rep. Scott Garrett (R-NJ) has introduced H.R. 3706, the "FHA Taxpayer Protection Act of 2009", which would increase the FHA downpayment to 5 percent and would prevent financing of the MIP or any other costs. We strongly oppose this legislation. Increasing FHA's downpayment

[4] Bankrate.com analysis, found on http://www.bankrate.com/finance/mortgages/state-by-state-closing-costs8-131404.aspx

would not add a penny to FHA's reserves. While it would increase an individual borrower's investment in the home, it would disenfranchise many FHA borrowers. Closing costs average 3-5 percent of the cost of a home. Those costs combined with the current 3.5 percent downpayment requirement are sufficient to insure a borrower's commitment to homeownership, and already represent a significant financial commitment. Requiring a larger downpayment will make homeownership out of reach for many families and for others could deplete their cash reserves for home and other emergencies.

FHA Loan Limits

We strongly support making permanent the FHA mortgage loan limits that are currently in effect. FHA has played a critical role in providing mortgage liquidity as private financing has dried up. We applaud Congress for extending the current loan limits through 2010, but they need to be made permanent.

Many argue that the loan limit increases help only the higher cost areas, but this is not the case. According to a recent HUD report, only 3 percent of FHA loans are above $362,750, and less than 2 percent are above $417,000. But decreasing the current loan limits would reduce the availability of mortgage loans in 612 counties in 40 states plus the District of Columbia. The resulting average reduction in limits would be more than $50,000. This decline would have a dramatic impact on liquidity in these markets, and could halt the housing recovery.

In addition, such a move could result in a greater risk to the stability of the FHA program since higher balance FHA loans perform better than lower balance ones. According to the FY 2009 audit, "FHA experience indicates that larger houses tend to perform better compared with smaller houses in the same geographical area, all else being equal."[5] So despite arguments that FHA higher limits put taxpayers at risk, these loans actually add strength to the program, and reduce risk to the fund.

Others argue that high FHA loan limits restricts private market activity. We strongly dispute this argument. FHA is currently acting in its role to fill the gap when the private market cannot or will not. If the current limits were restricting the development or resurgence of a private market, we would expect to see private lenders providing more new "jumbo" loans – above $729,750 since there is certainly demand for these loans in high cost areas. But in fact, we

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[5] *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund (Excluding HECMs)for Fiscal Year 2009*, by Integrated Financial Engineering Inc., November 6, 2009, pg 45.

find that there are few lenders willing to make these loans. When the private market returns, FHA will still have an important role in helping to serve the underserved in all parts of the country – even in high cost areas.

We strongly support the legislation introduced by Committee members Brad Sherman (D-CA) and Gary Miller (R-CA), H.R. 2483, the "Increasing Homeownership Opportunities Act," to make the current loan limits permanent. We urge the Committee to quickly consider this important legislation to ensure that FHA's role can continue in all markets for all credit-worthy consumers.

Condominium Rules

NAR has also been working closely with FHA on their new condominium approval process. As originally published in Mortgagee Letter 2009-19, we have concerns that some components of the new policy may lengthen the real estate crisis, just as some markets are seeing positive growth. We applaud the Department for delaying implementation of this letter and making temporary enhancements to the policy. While FHA has made some positive changes to their policy, we believe more can be done.

NAR recommends elimination of the owner-occupancy requirement for FHA condo mortgages. The GSEs do not have an occupancy ratio for condominium projects if the borrower is going to occupy the unit, which of course would be the case for all FHA borrowers. Eliminating this requirement will allow buyers to purchase condominiums (which are often more affordable), raise condominium owner-occupancy levels, and stabilize these developments and the community. If FHA retains the owner-occupancy ratio, NAR recommends amending the rules so that bank-owned REOs are not counted for the purposes of calculating the occupancy ratio. FHA amended the rules in this manner in their temporary condominium guidance (ML 2009-46 A), but we believe this should be included as a permanent part of the owner-occupancy calculation. Again, this will align FHA with the industry practices in this area.

Condominiums are often the only affordable option for first time home buyers or borrowers with good credit, but small downpayments. NAR recommends amending the FHA concentration requirement. Currently, no more than 30 percent of the total units in a project may have an FHA mortgage. While FHA has temporarily increased this limit to 50 percent, we believe that making the 50 percent cap permanent or increasing it further, will result in a greater owner-occupied ratio in and given project because more borrowers will be able to use FHA to purchase a primary residence.

Many new condominiums remain largely vacant because of our real estate crisis. But FHA requires that at least 50 percent of the units be sold prior to FHA's endorsement of a unit. This eliminates condominiums as an option for many FHA borrowers. FHA has temporarily reduced the requirement to 30 percent. Again, we believe that this reduction should be made permanent or eliminated so that the borrower has greater choice of available units.

NAR recommends reinstituting the Spot Loan Approval Process. Effective February 1, 2010, FHA no longer permits Spot Loans for condominiums in projects that do not have FHA approval. Elimination of the Spot Loan Approval Process reduces consumer choice significantly and does nothing to stabilize condominium projects in down markets. We understand that there were incidents of abuse with the Spot Loan Approval Process; however, eliminating this as an option for borrowers is an extreme response. NAR believes that FHA could develop appropriate measures to ensure Spot Loans are available to borrowers while protecting their risk.

Conclusion

The National Association of REALTORS® believes in the importance of the FHA mortgage insurance program and believes FHA has shown tremendous leadership and strength during the current crisis. Due to solid underwriting requirements and responsible lending practices, FHA has avoided the brunt of defaults and foreclosures facing the private mortgage lending industry. We applaud FHA for continuing to serve the needs of hardworking American families who wish to purchase a home.

We urge the Administration and Congress to move cautiously before making changes to a program that has served the needs of millions of American families for more than 80 years without needing a federal appropriation. FHA's recent audit shows that if FHA makes no changes to the way they do business today, the reserves will go back above 2 percent in the next several years. We urge caution in making changes to a critical part of our nation's economic recovery, and disenfranchising American families.

Written Testimony of David H. Stevens
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U.S. Department of Housing and Urban Development

"FHA Reforms, Legislative Proposals, and Contributions to the HUD FY 2011 Budget"

Hearing before the House Financial Services Subcommittee on
Housing and Community Opportunity
Thursday, March 11, 2010

Chairwoman Waters, Ranking Member Capito, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the Federal Housing Administration's (FHA's) recent reforms, legislative proposals, and contributions to the HUD FY 2011 budget request. As Congress affirmed with its recent extension of the first-time homebuyer tax credit, ensuring that we continue to support the housing market in the short-term and provide access to homeownership over the long-term, while minimizing the risk to the American taxpayer is of the utmost importance.

Helping Prevent an Economic Catastrophe

As you know, when this Administration took office just over thirteen months ago, the economy was hemorrhaging over 700,000 jobs each month, housing prices were in freefall, residential investment had dropped over forty percent in just eighteen months, and credit was frozen nearly solid. Many respected economic observers warned that a second Great Depression was a real possibility, sparked of course by a crisis in the housing market. Meanwhile, communities across the country—from central cities to newly built suburbs to small town rural America—struggled to cope with neighborhoods devastated by foreclosure, even as their soaring jobless rates and eroding tax base crippled their ability to respond.

As we move beyond the peak of the recent global financial crisis, though there is still a long way to go, it is clear that the nation's housing market has made significant progress toward stability. Through the combination of coordinated efforts by Treasury, HUD, and the Federal Reserve to stabilize the housing market, we are seeing real signs of optimism.

As measured by the widely referenced FHFA index, home prices have been rising more or less steadily since last April. As recently as January of 2009 house prices had been projected to *decline* by as much as 5 percent in 2009 by leading major macro-economic forecasters. This is all the more surprising since most forecasters had underestimated the rise in unemployment that has occurred over the past year.

Homeowner equity started to grow again – increasing by over $900 billion by the end of September, or $12,000 on average for the nation's nearly 78 million homeowners, and helping our economy grow at the fastest rate in six years in the fourth quarter of last year.

And mortgage rates which have been at or near historic lows over the past eleven months have spurred a refinancing boom that has helped nearly 4 million borrowers to save an average of $1,500 per year on housing costs – pumping an additional $7 billion annually into local economies and businesses, generating additional revenues for our nation's cities, suburbs, and rural communities.

FHA: Facilitating Recovery

While there remains uncertainty about whether this progress will continue at this pace going forward, particularly as we are currently in the typically-slow winter months, what is not in doubt is that the FHA has been central to much of this improvement.

Created by President Franklin Roosevelt at a time when two million construction workers were out of work and housing prices had collapsed, the FHA was designed to provide affordable homeownership options to underserved American families and keep our mortgage markets afloat during tough times.

And by insuring almost 30 percent of purchases and 20 percent of refinances in the housing market, FHA is certainly doing so today.

We know the critical role first-time homebuyers are playing in the market, including purchasing REO and vacant properties, helping stabilize home prices and communities alike. More than three-quarters of FHA's purchase-loan borrowers in 2009 were first-time homebuyers, and nearly half of all first-time buyers in the housing market in the second quarter of last year used FHA loans.

FHA provides mortgage insurance to help lenders reduce their exposure to risk of default. This assistance allows lenders to make capital available to many borrowers who would otherwise have no access to the safe, affordable financing needed to purchase a home.

As access to private capital has contracted in these difficult economic times, borrowers and lenders have flocked to FHA and the ready access it provides to the secondary market through securitization by Ginnie Mae. The increased presence of FHA and others in the housing market, including Fannie Mae and Freddie Mac, has helped support liquidity in the purchase market, helping us ride through these difficult times until private capital returns to its natural levels.

And with 51 percent of African Americans homebuyers and 45 percent of Hispanic families who purchased homes in 2008[1] using FHA financing, FHA is far and away the leader in helping minorities purchase homes.

FHA has stepped up to fulfill its countercyclical role – to temporarily provide necessary liquidity while also working to bring private capital back to credit markets. Indeed, the FHA has in the past year alone helped more than 800,000 homeowners refinance into stable, affordable fixed-rate mortgages.

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[1] Federal Financial Institutions Examination Council (FFIEC) 2008 Home Mortgage Disclosure Act (HMDA) data. Published on December 23, 2009, this is the most recent data available.

At the same time FHA has taken steps to reverse falling home prices, it has also worked to help families keep their homes, deploying its loss mitigation tools to assist a half million families at risk of foreclosure.

Not only is FHA ensuring the availability of financing for responsible first time home purchasers, it is also helping elderly homeowners borrow money against the equity of their homes through the Home Equity Conversion Mortgage (HECM). This program has grown steadily in recent years, to a volume of $30.2 billion in FY 2009.

And finally, FHA is playing an important role in protecting homeowners and helping prospective homeowners make informed decisions. It is providing counseling to homeowners to help them avoid falling into unsustainable loans. And it is fighting mortgage fraud vigorously on all fronts, having taken enforcement actions on more than six times as many lenders since FY 2009 than those over the FY 2000-2008 period combined.

The central role of housing in the U.S. economy demands that federal agencies involved in housing policymaking rethink and restructure programs and policies to support housing as a stable component of the economy, and not as a vehicle for over-exuberant and risky investing.

With that in mind, the President's Budget for 2011 represents a careful, calibrated balancing of FHA's three key responsibilities: 1) providing homeownership opportunities to responsible borrowers, 2) supporting the housing market during difficult economic times and 3) ensuring the health of the FHA Mutual Mortgage Insurance (MMI) fund.

With this Budget, HUD is projecting that FHA will continue to play a prominent role in the mortgage market in fiscal year 2011. Accordingly, it requests a combined mortgage insurance commitment limitation of $420 billion in fiscal year 2011 for new FHA loan commitments for the Mutual Mortgage Insurance (MMI) and General and Special Risk Insurance (GI/SRI) funds. The proposed total includes $400 billion under the MMI Fund, which supports insurance of single family forward home mortgages and reverse mortgages under HECM; and $20 billion under the GI/SRI Fund, which supports multifamily rental and an assortment of special purpose insurance programs for hospitals, nursing homes, and Title I lending. The budget requests a direct loan limitation of $50 million for the MMI fund and $20 million for the GI/SRI fund to facilitate the sale of HUD-owned properties acquired through insurance claims to or for use by low- and moderate-income families.

The Budget also includes $88 million for the Housing Counseling Assistance program, which is the only dedicated source of Federal funding for the full spectrum of housing counseling services. With these funds we also plan to continue our work to expand the number of languages in which counseling is available. In addition, the budget continues FHA's Mortgage Fraud initiative ($20 million) launched in fiscal year 2010 as well as implementation of sweeping reforms to the Real Estate Settlement and Procedures Act (RESPA) which began in January 2010 and the Secure and Fair Enforcement (SAFE) for Mortgage Licensing Act beginning in June 2010.

Rebuilding FHA's Capital Reserves

As important as FHA is at this moment to our nation's economy, FHA has not been immune to the hard times for the housing sector. Late last year, we reported to Congress that FHA's secondary reserves had fallen below the required two percent level – to 0.53 percent of the total insurance-in-force. However, when combined with reserves held in the Financing Account, FHA reported with its FY 2009 actuarial review that it holds more than 4.5 percent of total insurance-in-force in reserves – $31 billion set aside specifically to cover losses over the next 30 years.

As such, the independent actuary concluded that FHA's reserves will remain positive under all but the most catastrophic economic scenarios.

Further, while its Capital Reserve Account has decreased too quickly, FHA is not "the next subprime" as some have suggested.

Subprime delinquencies are 240 percent higher than FHA's for a reason – subprime loans had much weaker underwriting standards than FHA. While others participated in investor-owned markets or were exposed to exotic mortgages such as option-ARMs and interest-only loans, and while some tolerated lax underwriting standards, FHA stuck to the basics during the housing boom: 30-year, fixed rate traditional loan products with standard underwriting requirements. Unlike subprime lenders, FHA requires that borrowers demonstrate they can pay their mortgage by verifying their income and employment.

All of that said, Madam Chairwoman, we've learned from recent history that the market is fragile, and we have to plan for the unexpected. That uncertainty is complicated by an organization we inherited that, to be honest, was simply not properly managing or monitoring its risk.

Credit and risk controls were antiquated. Enforcement was weak. And our personnel resources and IT systems were inadequate.

Little of this may have been obvious when FHA's market share was 3 percent as recently as 2006. But when our mortgage markets collapsed, and homebuyers increasingly turned to the FHA for help, the potential consequences of these lapses in risk management became very clear.

Reforms to Date

From my first day as FHA Commissioner, I began a thorough review of our loan practices and organizational capacity and gaps. We have already taken several steps within our existing authority to shore up the FHA and continue to improve our operations to ensure that taxpayers are not put at risk.

In addition to steeply increasing lender enforcement, we've strengthened credit and risk controls – toughening requirements on our Streamlined Refinance program, made several improvements to the appraisal process, and proposed a rule to increase net worth requirements for all FHA lenders. During the comment period on this rule, we received over 200 public comments which

provided valuable information from industry members about certain aspects of the rule and we have tried to address those concerns to the extent feasible in the final rule. The final rule is currently undergoing review before publication in the *Federal Register*.

Long overdue, FHA hired its first Chief Risk Officer, Robert Ryan, who sits next to me here today, to provide the most comprehensive and thorough risk assessment in the organization's history – and ensure that the assumptions going into our modeling reflect the most current economic conditions.

In addition, with Congress' help, we are working to increase staffing and technical capacity and upgrade our technology systems – and though we still have a long way to go, we delivered FHA's first comprehensive technology transformation plan to Congress in September. We have continued to make progress on both fronts. We are weeks away from taking a major step to upgrade our risk and fraud tools and we recently delivered a FHA Staffing Report to Congress, which outlines our significant progress towards hiring the 118 FTEs that we thank Congress for appropriating to FHA in FY 2010, along with details on an aggressive training and human capital development plan that includes managerial and technical skill building training as well as on-the-job mentoring.

Lender Enforcement

Under the Obama Administration, FHA has significantly increased its lender enforcement activities to protect the MMI Fund, consumers, and address a number of bad actors that were previously not held accountable.

Since July 1, 2009, the Mortgagee Review Board (MRB) has investigated 365 cases, resulting in withdrawal of approval for 354 lenders and suspension of an additional 6 lenders. The number of cases that have been investigated by the MRB since July 2009 are greater than those investigated in the years 2002-2008 combined[2]. We take our responsibility to oversee lenders with the utmost seriousness. I would also like to emphasize that FHA's intent is to protect the Fund through a commitment to lender enforcement, but FHA in no way intends to punish responsible lenders. We are working closely with lenders to identify best practices and share them among the lending community, proactively identify problem situations and identify means to improve performance, to the benefit of lenders, consumers, and the FHA.

January Policy Announcements and Legislative Requests

On January 20th of this year, I proposed taking the following steps to mitigate risk and augment the MMI Fund's capital reserves: increase the mortgage insurance premium (MIP); impose a firm floor on allowable credit scores, and further tighten the minimum credit score required for borrowers with low down payments; reduce the maximum permissible seller concession to match the industry norm; and implement a series of significant measures aimed at increasing lender responsibility and enforcement. Thank you for the opportunity to explain these policies in more detail.

[2] See Appendix for Historical Data on Mortgagee Review Board Actions

I would like to be clear that many of these reforms were long overdue as FHA did not respond effectively to changes in the marketplace that happened during the housing boom and the subsequent decline – inaction was and is not an option. In addition to the Congressional mandate to take action to bring FHA's capital reserves back up above 2%, FHA also has a responsibility to protect consumers from irresponsible lending practices, protect the taxpayer from excessive claims on the MMI fund, and facilitate the return of private capital to the mortgage market. We take these responsibilities seriously, as evidenced by the series of policies that we have already enacted and those that we request Congressional authority to enact.

FHA conducted an exhaustive review of loan performance in its portfolio and a thorough policy development process to ensure that these policy changes balance three guiding principles: 1) improve FHA loan performance and capital reserves, 2) continue to support the broader housing market and recovery, and 3) preserve FHA's role in providing homeownership opportunities to responsible underserved borrowers. Each one of our policy changes fulfills these three priorities. Additionally, FHA evaluated several dozen other policy options which ultimately were not chosen as they did not strike the appropriate balance. With these factors, in mind, FHA has proposed a series of balanced policy proposals that fulfill our responsibility to the American taxpayer and recognizes the important role that FHA is currently playing in the recovery of the housing market.

Restructuring FHA Mortgage Insurance Premiums

First, insurance revenues from single family loan guarantees will grow by increasing the upfront premium to 225 basis points across all FHA forward product types (purchase, conventional to FHA refinances, and FHA to FHA refinances). The upfront premium increase was implemented by mortgagee letter issued on January 21, 2010 and will apply to all applications received on or after April 5, 2010. I would like to thank Congress for providing FHA with the flexibility to increase the upfront premium to a maximum of 300 basis points through passage of the Housing and Economic Recovery Act (HERA) in 2008. While we have not chosen to increase the upfront premium to the maximum, this flexibility has enabled FHA to take immediate action to begin rebuilding our capital reserves. Similarly, we request flexibility in our legislative proposal to increase the annual premium to 150 basis points although we have not proposed to increase the annual premium to that level in our FY 2011 budget proposal.

As noted in the proposed budget, while HUD is moving to increase the upfront premium to 225 basis points we are ultimately planning to reduce that premium to 100 basis points, offset by a proposed increase in the annual premium to 85 basis points for loans with loan-to-value ratios (LTV) up to and including 95% and to 90 basis points for LTVs above 95%.

This change to the annual premium will require legislative authority, and we are looking forward to working with the authorizing committees as part of that effort. I would note that this bill is in circulation, and we have provided the Subcommittee with a copy. Given the importance of these issues to FHA's ability to facilitate our recovery while protecting the taxpayer, we hope that appropriators and authorizers will move to pass it as expeditiously as possible.

We believe this new premium structure is sound policy – more in line with GSE and private mortgage insurers' pricing, and is intended to facilitate the return of private capital to the

mortgage market.[3] Indeed, if these changes are adopted during the current fiscal year, the estimated value to the MMI fund would be approximately $300 million per month, which would replenish FHA's capital reserves even faster than if this authority was provided through the annual appropriations process.

This restructuring of FHA's mortgage insurance premiums will accomplish two very important goals: 1) increase the homeowner's equity in each mortgage transaction and reduce the risk to the FHA fund, and 2) facilitate the return of private capital to the mortgage market.

Increasing Equity in FHA Loans

As stated earlier, if granted legislative authority to increase the annual mortgage insurance premium, FHA proposes to reduce the upfront mortgage insurance premium from 225 basis points to 100 basis points. Borrowers typically finance the upfront mortgage insurance premium in their loan balance, increasing the effective loan-to-value and reducing the amount of equity in their home. The reduction of the upfront premium will lower the loan balance as well as add an additional 125 basis points of equity to each loan purchase.

Facilitating the Return of Private Capital to the Mortgage Market

As noted, the elevated role FHA is currently playing in the market is temporary. In addition to being more equitable for borrowers and generating more receipts for FHA, this change to the FHA premium structure brings FHA's pricing more in-line with the private mortgage insurance industry and enables more robust private competition. In fact, in response to FHA's announced policy changes, MGIC, the largest U.S. private mortgage insurer, announced on February 23rd that it would be adopting a new pricing scale to better compete with FHA.[4]

Updating Credit Score / Downpayment Guidelines

FHA is also proposing a "two-step" FICO floor for FHA purchase borrowers, which would reduce both the claim rate on new insurance as well as the loss rate experienced on those claims. Purchase borrowers with FICO scores of 580 and above would be required to make a minimum 3.5% down payment; and those with FICO scores between 500-579 would be required to make a minimum down payment of 10%. Applicants below 500 would be ineligible for insurance. FHA plans to publish the two-step FICO proposal in the Federal Register soon, with implementation planned later this fiscal year.

Careful analysis of the existing FHA loan portfolio shows a clear performance difference between loans that were made below the proposed FICO/LTV guidelines. Loans below the guidelines are currently more than four times as likely to be seriously delinquent than loans above the guidelines. Loans below the guidelines demonstrate a seriously delinquent rate of 31.1%, while loans above the guidelines currently demonstrate a seriously delinquent rate of 7.6%. Of the total FHA loan portfolio, approximately 6% of loans fall under the proposed guidelines; however, due to improved quality of recent FHA loans, only 1.5% of loans endorsed in FY2009 would be excluded under the proposed guidelines.

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[3] See Appendix for detailed information about the effect of proposed premium rate changes on home buyers.
[4] "*MGIC Lowers Rates to Compete With U.S.-Backed Mortgage Insurers,*" Bloomberg, February 23, 2010.

Loan Performance Based on Proposed Updated Credit Score / Downpayment Guidelines

Proposed Two Step Rule	Outstanding Loans	30-Day	60-Day	90-Day	In Foreclosure	In Bankruptcy	Seriously Delinquent (90-Day+)
Excluded	6.2%	12.1%	6.7%	19.9%	8.1%	3.0%	31.1%
Still Qualify	93.8%	5.0%	2.1%	4.9%	2.0%	0.7%	7.6%
Total	100.0%	5.5%	2.4%	5.9%	2.4%	0.8%	9.1%

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

If implemented, in combination with the proposed mortgage insurance premium structure, the updated FICO/LTV guidelines are projected to result in the $5.8 billion in offsetting FHA receipts as reflected in the President's Budget.

Minimum Downpayment for FHA Loans

Some have suggested that FHA raise the minimum required downpayment to 5% across the board and also remove the option of financing the upfront insurance premium into the loan balance for all transactions as a means to increase homeowner equity. We share the goal of increasing equity in home purchase transactions, but determined after extensive evaluation that such a proposal would adversely impact the housing market recovery.

To determine the impact of requiring a minimum 5% downpayment for all transactions, FHA evaluated the loan files of a large sample of past endorsements to identify the number of borrowers who had sufficient assets at time of loan application to contribute the additional 1.5% of equity at closing. As illustrated in the table below, such a policy change would reduce the volume of loans endorsed by FHA by more than 40%, while only contributing $500 million in additional budget receipts. This translates to more than 300,000 fewer first-time homebuyers and would have significant negative impacts on the broader housing market – potentially forestalling the recovery of the housing market and potentially leading to a double-dip in housing prices by significantly curtailing demand. In contrast, the combination of policy changes proposed by FHA in the FY 2011 budget would contribute an additional $4.1 billion in additional receipts to FHA while having a much more moderate impact on the broader housing market.

Impact of FY 2011 Policy Options on FHA Receipts and Loan Volume

Policy Option	FHA Receipts ($ Billions)	FHA Loan Endorsements ($ Billions)
Baseline without policy changes	$1.7	$246
Minimum 5% downpayment for all transactions	$2.2	$139
FY2011 Budget Proposal with all proposed policy changes	$5.8	$223

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

Furthermore, downpayment alone is not the only factor that influences loan performance. 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% 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, as illustrated below.

FHA Single Family Insured Loan Claim Rates
Relative Experience by Loan-to-Value and Credit Score Values[4]

Ratios of each Combination's Claim Rate
to that of the Lowest Risk Cell[5]

Loan-to-Value Ratio Ranges	Credit Score Ranges[6]			
	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 FHA has decided to reduce the upfront mortgage insurance premium, which is financed into the loan balance in the vast majority of transactions, and increase the annual mortgage insurance premium, which is paid over time and not financed into the loan balance, which is more aligned with the premium structure of private mortgage insurance companies.

In particular, we have proposed to permit loans to borrowers with FICO scores above 580 with a minimum 3.5% downpayment and loans to borrowers with FICO scores between 500 to 579 with a minimum 10% downpayment. It is also worth noting that these downpayment guidelines are *minimums* and many borrowers do in fact have significantly lower LTVs – in the fourth quarter of FY 2009, more than 21% of endorsed loans had a LTV lower than 90%.

Reducing Seller Concessions

We are also proposing a third policy measure to reduce the maximum permissible seller concession from its current 6 percent level to 3 percent, which is in line with industry norms. The current level exposes the FHA to excess risk by creating incentives to inflate appraised value. As seen in the table below, FHA's experience shows that loans with high levels of seller concessions are significantly more likely to go to claim. Experience to-date on loans insured from FY 2003 to

[4] 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.
[5] 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.
[6] 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.

FY 2008 suggests that claim rates on high-concession loans are 50 percent higher or more than those on low-concession loans.

FHA Single-Family Insurance To-Date Claim Rate Comparison Low (0-3%) vs. High (3.1-6%) Seller Concessions[5] As of December 31, 2009			
Endorsement Fiscal Year	Low Concessions	High Concessions	Ratio High/low
2003	6.5%	10.7%	1.65
2004	6.6	11.6	1.76
2005	7.2	11.2	1.54
2006	6.5	9.5	1.46
2007	4.6	6.3	1.36
2008	1.0	1.5	1.60

Source: US Department of Housing and Urban Development, Federal Housing Administration; January 2010.

Increasing Lender Enforcement

In its FY 2009 Actuarial Review, the independent actuary projected that more than 71 percent of FHA's losses over the next 5 years will come from loans already on our existing books, rather than from newly insured loans. That's why an important step we can take to minimize losses to capital reserves in the near term is to step up enforcement and make lenders more accountable. As mentioned earlier, we have renewed our focus on enforcement and lender accountability.

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 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. FHA is simply requesting that Congress permit FHA to hold all lenders to the same standard; FHA is not asking for expansion of authorities beyond those already granted to FHA to oversee lenders participating in the LI program.

As you can see, we have proposed a comprehensive set of reforms to improve loan performance, hold lenders accountable, and increase revenues to the FHA fund, while also ensuring that FHA continues to support the overall recovery of the housing market and continue to serve its mission of providing homeownership opportunities for responsible borrowers. We look forward to working with Congress closely on all these issues and hope to gain your support for our legislative requests to further reduce risks to the American taxpayer.

[5] As a percentage of the home price. This analysis is only for home purchase loans.

CBO Scoring

Last Friday, the Congressional Budget Office released its re-estimate of the President's 2011 Budget. Although the CBO re-estimate includes a significantly more conservative assessment of how new loans made through FHA's MMI Fund will perform in coming years, both CBO and the Administration forecast that such credit activity will result in net receipts to the Government. We differ, however, on the amount. While the President's Budget forecast $5.8 billion in net receipts resulting primarily from insurance premia and other fees assessed on FHA loans, CBO re-estimated those net savings at $1.9 billion. Accordingly, CBO's scoring suggests our policies will cost $3.9 billion more than we estimated in our submission to you.

While recognizing that such a difference with CBO complicates budget resolution development, we remain confident that the $5.8 billion in receipts forecast in the President's Budget will be realized and transferred to FHA's Capital Reserve Account. This will help that fund get back on track to be capitalized with the statutorily mandated two percent of insurance in force.

Home Equity Conversion Mortgage (HECM)

This year, we are requesting an appropriation of $250 million to support FHA's reverse mortgage product - the Home Equity Conversion Mortgage, or HECM, program. The HECM program provides seniors with a means to access their home equity to make ends meet. A survey conducted by AARP in 2006 showed that the product provided seniors with much-needed financial relief and was primarily used to pay for long term health care, enable home repairs, and provide piece of mind that housing expenses could be met.[6] Another study, conducted by the National Council on Aging in 2005 showed how the program can help seniors access in-home health care services, an arrangement that allows households to "age in place" rather than undergoing disruptive transitions into nursing homes or other types of public facilities to receive health-related assistance. Keeping seniors in their homes and communities, close to familiar support networks, puts less pressure on our nation's overextended nursing home infrastructure and the public resources that support it.

We have performed considerable analysis to perform the maximum policy changes that we could perform to reduce risk to the taxpayer and maintain the viability of the program, which is why we have proposed for FY2011 an increase in the annual mortgage insurance premium from 0.50% to 1.25% and a further reduction in the principal limit factors (PLFs) of approximately one to five percent depending on the age of the borrower, on top of the 10% reduction in PLFs that was implemented at the beginning of FY2010.

Without the budget request, we would be forced to reduce the PLFs by an additional 21% in FY2011. This would significantly reduce the amount of funds that would be available to seniors (more than 30%), which is on average a $23,000 to $27,000 impact.

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[6] "Reverse Mortgages: Niche Product or Mainstream Solution? Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers," AARP Public Policy Institute Paper #2007-22. and *"Use Your Home to Stay at Home,"* National Coalition on the Aging, 2005. http://www.ncoa.org/news-ncoa-publications/publications/reversemortgagereportpublications.pdf

Any additional steep cut to the PLFs will result in serious decline in program level as HECMs would no longer be viable to many seniors who need to access their home equity while staying in their homes. It is important to note that the need for this type of program is greater now than it's ever been, due to increasing medical costs, declining employment/incomes, and less "savings" in various types of pension funds/retirement accounts.

Forecasts suggest that future house prices will grow more slowly than in the past, and the HECM program costs are very sensitive to future house prices. As such, we have also assembled a working group with the Department to see what other kinds of broader program changes could be made going forward to make the program more viable even under stressful economic times.

Given the value of this program in assisting this critical population, HUD has requested an appropriation to maintain the viability of this option for seniors while we evaluate the range of broader program changes that may be necessary to ensure the success of the HECM program into the future.

HUD's Central Role in Preventing Foreclosures and Stabilizing Neighborhoods

In addition to efforts to improve the execution of MHA, HUD is utilizing long-existing mechanisms as well as additional authority provided in recently enacted legislation to aid distressed homeowners and to address community blight resulting from foreclosed and abandoned properties.

Established FHA Loss Mitigation Efforts.[7] Homeowners of FHA-insured loans have long been eligible for a variety of loss mitigation programs to help protect them from foreclosure. In 2009, more than 450,000 families were assisted through a variety of methods, including forbearance, partial claim, loan modification, pre-foreclosure sale, and deed-in-lieu of foreclosure. In the first quarter of FY 2010, FHA assisted more than 122,000 through these programs. Servicers of FHA-insured loans are required to notify delinquent homeowners about the option(s) that are available to help them make their monthly payments and to implement loss mitigation efforts before they take the final step of initiating foreclosure proceedings.

FHA-Home Affordable Modification Program (FHA-HAMP). When initially introduced to the public, the Making Home Affordable program excluded FHA-insured mortgages and stated that FHA would develop its own stand alone program. On July 30, HUD announced final rules implementing the FHA's program -- the FHA Home-Affordable Modification Program (FHA-HAMP) -- which is an important complement to MHA and provides homeowners in default (or at-risk of imminent default) with greater opportunity to reduce their mortgage payments to a sustainable level. All servicers were expected to begin offering FHA-HAMP by August 15. This new loss mitigation program was authorized under the "Helping Families Save Their Homes Act of 2009," signed into law on May 20, and allows FHA to give qualified FHA-insured borrowers the opportunity to obtain assistance under terms roughly comparable to borrowers in other segments of the market, without increasing costs to the taxpayer. This program allows HUD to permanently reduce a family's monthly mortgage payment to an affordable level by offering a partial claim of up to 30% of the unpaid principal balance. This defers the repayment

[7] See appendix for description of FHA's loss mitigation programs.

of the mortgage principal reduction through an interest-free subordinate mortgage that is not due until the first mortgage is paid off.

At the initiation of FHA HAMP in August of 2009, it was projected to provide assistance to over 45,000 households over the next three years. As of January 31, 2010, lenders have sent over 15,000 trial plans and over 10,000 borrowers have made at least 1 payment on their trial plan. FHA-HAMP loan volume is currently above projections for the three year milestone and all but one major lender has borrowers under a trial program.

Pay for success payments were included for borrowers and servicers that utilized the conventional HAMP. However, at the time of its announcement, FHA-HAMP did not include Pay for Success payments for servicers or mortgagors that made on time payments as it required regulatory action to be eligible for FHA-insured mortgages. We have worked diligently to complete this process and FHA will issue a mortgagee letter in the coming days that will enable FHA-HAMP borrowers and servicers to be eligible for Pay for Success payments. Consequently, it is expected that demand for FHA-HAMP will increase.

Assistance for Borrowers Facing Imminent Default. On January 22, 2010, FHA announced that it was exercising authority granted to it by Congress through the *Helping Families Save Their Home Act of 2009* to use its loss mitigation tools to assist FHA borrowers avoid foreclosure to include those facing "imminent default" as defined by the Secretary. Homeowners with FHA-insured mortgage loans who are experiencing financial hardship are now eligible for loss mitigation assistance before they fall behind on their mortgage payments. Previously, these homeowners were not eligible for such assistance until after they had missed payments. Now servicers will have additional options for those borrowers who seek help before they go delinquent, which increases the likelihood that the borrower will be able to retain their home.

The borrower must be able to document the cause of the imminent default which may include, but is not limited to, one or more of the following types of hardship:

- A reduction in or loss of income that was supporting the mortgage loan, e.g., unemployment, reduced job hours, reduced pay, or a decline in self-employed business earnings. A scheduled temporary shutdown of the employer, (such as for a scheduled vacation), would not in and by itself be adequate to support an imminent default.
- A change in household financial circumstances, e.g., death in family, serious or chronic illness, permanent or short-term disability

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 findings have already been identified and FHA has begun to share them with servicers, while continuing to meet with additional lenders to identify additional best practices that will enable underperforming servicers to improve their success with preventing foreclosures. It is worth noting that these best practices are not limited to the FHA population, and HUD's efforts in this area will benefit all homeowners, not only those with a FHA-insured mortgage, by collaborating with the servicer community to improve their foreclosure prevention activities across the entire industry.

Counseling. HUD is utilizing its vast network of counselors and other nonprofits to provide critical assistance to the record number of homeowners at-risk of foreclosure. It is estimated that more than half of all foreclosures occur without servicers and borrowers ever engaging in a discussion about potential options to prevent foreclosure. That is why we have directed HUD-approved counselors to educate homeowners about their various options, promote the MHA program in local communities, and assist distressed homeowners with navigating the system so they can reach servicers and obtain assistance to avoid foreclosure.

HUD-approved counselors are located across the nation and provide distressed homeowners with a wealth of information. The counselors provide assistance over the phone and in person to individuals seeking help with understanding the Making Home Affordable program, explain options available to FHA-insured homeowners, and often work with borrowers eligible for the Administration's refinance or modification program to compile an intake package for servicers. These services are provided free of charge by nonprofit housing counseling agencies working in partnership with the federal government and funded in part by HUD and NeighborWorks® America. In addition, HUD, working with Treasury and the Homeownership Preservation Foundation, encourages distressed borrowers to contact the Homeowner's HOPE Hotline at 866-995-HOPE to receive counseling and advice on avoiding foreclosures. The 24 hours a day, seven days a week hotline utilizes many HUD-approved counselors who can also help the homeowner reach and resolve issues with servicers.

Neighborhood Stabilization Program (NSP). HUD recognizes that concentrated foreclosures can wreak havoc on once-stable communities and is working to insure that the nearly $6 billion appropriated by Congress for NSP plays the intended role of helping to stabilize housing markets and combat blight through the purchase and redevelopment of foreclosed and abandoned homes and residential properties. NSP is starting to generate real results and is emerging as a vital resource in facilitating the transformation of foreclosed homes into affordable housing and other useful properties. HUD continues to monitor program activities, identify strategies that produce real results, and work to make program modifications that will help ensure that this funding is deployed quickly, wisely, and effectively. Additionally, FHA and HUD's Office of Community Planning and Development have created a working group to assist NSP grantees to better coordinate the use of NSP funds for the purchase of FHA REO properties.

Facilitating our Recovery, But Protecting the Taxpayer

Madam Chairwoman and Ranking Member Capito, shoring up the FHA won't solve all our housing challenges – 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.

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 the continued ability to purchase a home, the changes and legislative requests that we have announced are crafted to ensure FHA steps back to facilitate the return of the private sector as soon as possible. Until the private sector can step back up, they need the FHA – and so does our housing market.

So, Madam Chairwoman, 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: the loans FHA insures must be safe and self-sustaining for the taxpayer over the long-term. With these reforms the Administration is committed to ensuring that they are today – and into the future. Thank you.

Appendix

MORTGAGEE REVIEW BOARD HISTORICAL ACTIONS BY FISCAL YEAR	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Number of Cases	**61**	**92**	**14**	**63**	**47**	**38**	**21**	**18**	**95**	**593**	**360**
Fact Based Cases	61	92	14	63	47	38	21	18	30	21	40
Recertification Cases		-	-	-	-	-	-	-	65	572	320
Actions Taken											
Withdrawal Of Approval	15	29	2	4	8	10	3	3	27	268	314
Suspension	1	1	0	0	0	0	0	0	1	6	1

Fact Based Cases – are those referrals to the board as a result of a review of the lenders origination, underwriting and/or operations; primarily the result of the Single Family Quality Assurance Division's lender monitoring reviews, but the board also receives referrals from the OIG, Multi-Family, etc.

Recertification Cases – are referrals to the MRB from the Office of Lender Activities Lender Recertification branch and are the result of a lender's failure to follow our annual renewal process. The addition of this new category in FY2008 was primarily due to the new requirements issued from the decision by HUD's Administrative Law Judge in FY 2008 that all lenders that do not comply with FHA's annual renewal requirements must go before the Board for administrative action.

Withdrawal of Approval – terminates the FHA-approval of a lender, e.g. lenders lose their FHA Approval Status and have no authority to originate and/or underwrite FHA loans.

Suspension – temporarily suspends an FHA-approved lenders ability to originate and/or underwrite FHA loans. It does not terminate their FHA Approval, just the ability to use it.

FHA Single Family Insurance Effect of Proposed Premium Rate Changes on Home Buyers Who Make the Minimum Cash Investment

Home Price and Mortgage Payment Components	With Current MIP Values (175/55)	With Interim 225/55 MIP Plan	Difference from Current Values	With Proposed 100/90 MIP Plan	Difference from Current Values
House price - Average Value	$176,000	$176,000		$176,000	
Base Loan Amount (96.5% LTV)	$169,840	$169,840		$169,840	
Loan Amount with UFMIP	$172,812	$173,661	$849	$171,538	-$1,274
Interest Rate	5.50%	5.50%		5.50%	
FHA upfront MIP rate	1.75%	2.25%		1.00%	
FHA annual MIP rate	0.55%	0.55%		0.90%	
Principal and Interest payment	$981	$986	$5	$ 974	-$7
PITI payment[7]	$1,355	$1,360	$5	$1,348	-$7
PITI + FHA Mortgage insurance payment (full mortgage payment)	$1,434	$1,439	$5	$1,475	$42

Source: US Department of HUD/FHA; February 2010. Average values are for FHA-insured home-purchase borrowers, October-December 2010.

[7] This assumes that property taxes and hazard insurance payments (TI) amount to 2.55% of the property value. This figure is backed into from the difference between the average mortgage payment ratio of FHA-insured borrowers and the payment without the TI portion. PITI refers to principal, interest, taxes, and insurance.

Description of HUD's Loss Mitigation Program Tools

Formal Forbearance
A short term repayment plan to postpone, reduce, or suspend payment due on a loan for a limited and specific time period. A formal forbearance is normally entered into when a borrower is in imminent default or early delinquency and can be as simple as a promise-to-pay.

Special Forbearance
A long term repayment plan that may provide for periods of reduced or suspended payments when there is reasonable likelihood the borrower can resume normal or increased payments.

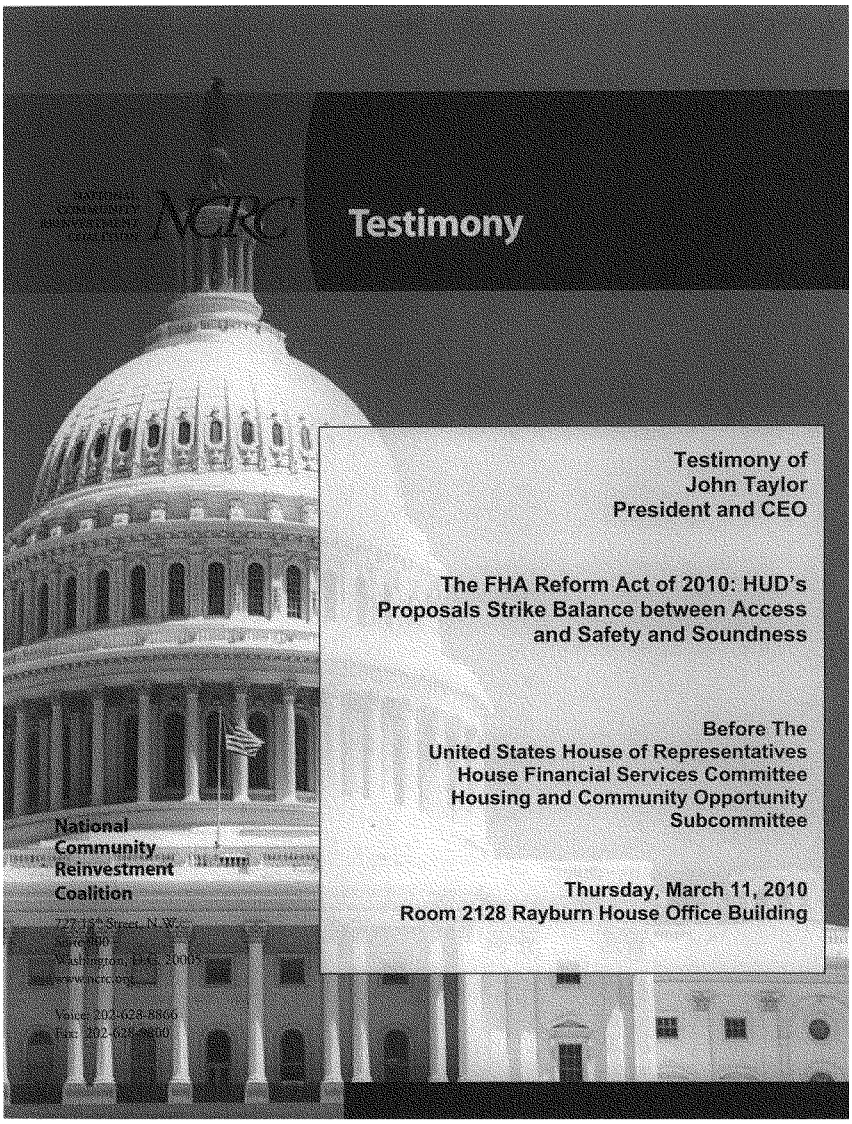
Mortgage Modification
Provides a permanent change in the monthly mortgage payment by capitalizing the accumulated arrears and establishing a new mortgage term of up to 30 years.

Partial Claim
A promissory note and subordinate mortgage to cover the advance for delinquent mortgage payments is issued in the name of the Secretary of HUD.
Mortgagee advances funds on behalf of the Mortgagor in the amount of the Partial Claim advance to reinstate the delinquent loan.

FHA-HAMP
FHA-HAMP allows qualified FHA-insured borrowers to reduce their monthly mortgage payment to an affordable level by permanently reducing the payment through the use of a partial claim combined with a loan modification. The partial claim defers the repayment of a portion of the mortgage principal through an interest-free subordinate mortgage that is not due until the first mortgage is paid off. The remaining balance is then modified through re-amortization and in some cases, an interest rate reduction.

Pre-Foreclosure Sale
Homeowner sells the property at a price less than the outstanding mortgage balance and HUD pays an insurance claim to the mortgagee for the resulting loss.

Deed-In-Lieu of Foreclosure
Voluntary transfer of property title to the lender or directly to HUD.


NCRC
Testimony
Testimony of
John Taylor
President and CEO
The FHA Reform Act of 2010: HUD's
Proposals Strike Balance between Access
and Safety and Soundness
Before The
United States House of Representatives
House Financial Services Committee
Housing and Community Opportunity
Subcommittee
Thursday, March 11, 2010
Room 2128 Rayburn House Office Building
National
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Introduction

Good morning, Chairman Waters, Ranking Member Capito, and other distinguished members of the Subcommittee. My name is John Taylor and I serve as President and CEO of the National Community Reinvestment Coalition (NCRC). I am honored to testify today before the Housing and Community Opportunity Subcommittee of the House Financial Services Committee on behalf of NCRC on the topic of the Federal Housing Administration (FHA) program and suggestions for reform.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

NCRC applauds you for holding this important hearing on the FHA because the success of the FHA remains important for the housing market and the broader economic vitality of our country. When it was created in 1934, FHA's original mission was to promote homeownership widely and to build economic prosperity. FHA successfully achieved its mission by standardizing a safe, sound, and straightforward product – the 30 year fixed-rate mortgage with a downpayment requirement. FHA's role in the current economic crisis is similar to its original role. The crisis has sharply curtailed the amount of private sector loans to the point where FHA and the Government-Sponsored Enterprises (GSE) now own or guarantee around 80 to 90 percent of the new mortgage loans being made. By the end of 2008, almost one half of the home purchase loans and one quarter of the refinance loans were FHA or VA insured.[1] FHA is thus performing a vital countercyclical role of preventing housing markets from crashing and preserving and promoting economic stability and growth.

Currently, a broader range of applicants are using the FHA program. Middle- and upper-income borrowers as well as the traditional FHA first-time homebuyers are using the program in heavy

[1] Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, Glenn B. Canner, Christa N. Gibbs, *The 2008 HMDA Data: The Mortgage Market during a Turbulent Year*, in the Federal Reserve Board Bulletin, September 30, 2009, p. 20, see http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft.pdf.

volumes.[2] The broader use is most likely a short-term aberration and the FHA Commissioner has spoken about how he wants to return FHA to its focus on first-time homebuyers and underserved communities. Today's widespread use of FHA, however, illustrates that it has broad benefits for the U.S. population as a whole.

In this context, the Department of Housing and Urban Development's efforts to shore up the safety and soundness of the FHA are welcome steps. NCRC is supportive of the discussion draft bill, FHA Reform Act of 2010, which incorporates HUD's legislative suggestions regarding underwriting and enforcement authority.

The previous Administration allowed the FHA to be understaffed and had not updated underwriting criteria in some time.[3] This inattention, combined with the overall foreclosure crisis, contributed to the FHA's secondary reserves being lower than the Congressionally mandated level. NCRC is supportive of the proposed changes to underwriting standards that aim to reduce delinquencies and bolster safety and soundness. At the same time, it is important that HUD does not overreact to the crisis and implement unnecessarily tight standards that do not contribute to safer mortgages but that constrict credit. FHA clearly has an important countercyclical role, bolstering consumer demand for mortgages in steep recessions and serving underserved communities. If the tightening goes too far, the countercyclical role is endangered. In addition to supporting the steps so far on underwriting, NCRC heartily applauds the increased enforcement HUD has taken against unscrupulous lenders participating in the FHA program. The enforcement will be very beneficial to promoting responsible lending for communities and restoring the health of the reserve fund.

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[2] Lisa Nelson of the Cleveland Federal Reserve finds an increase in upper-income usage of FHA loans. See Lisa Nelson, *A Look Behind the Numbers: FHA Lending in Ohio*, December 2009, via http://www.clevelandfed.org/Community_Development/publications/ALBTN/V2_5/index.cfm

[3] Dina Elboghdady and Dan Keating, *The Next Hit: Quick Defaults – More FHA-Backed Mortgages Go Bad Without a Single Payment* in The Washington Post, Sunday, March 8, 2009.

FHA's Lending Trends and Focus

For many decades, FHA had a prominent role in the marketplace, ranging from guaranteeing 30 percent of the loans in the 1970's to 15 to 20 percent in most of the 1990's.[4] With the rise of subprime lending, however, FHA's market share shrank while subprime market share increased. In 2005, the share of mortgages insured by FHA was only about 4.5 percent while subprime loans constituted about 18 percent of home purchase loans. The inverse relationship between the FHA and subprime market share is due in part to the similar group of borrowers both types of lending were serving. The credit profiles of borrowers of these loan types are not identical but both FHA and subprime loans were serving a population that was not the mainstay of traditional banks.

Ultimately, FHA lending proved to be more sustainable than the loosely underwritten subprime loans. After the crash of subprime lending in 2007 and 2008, FHA's market share is now 25 to 30 percent of mortgage loans.[5]

Loan performance data shows that FHA lending is more durable than subprime lending. According to the Office of the Comptroller of the Currency and the Office of Thrift Supervision, 8.3 percent, 16 percent, and 20.1 percent of government-guaranteed mortgages, option Adjustable Rate Mortgages (ARMs), and subprime loans, respectively, were seriously delinquent as of the third quarter 2009. In addition, 2.5 percent of government-insured mortgages as opposed to 11.9 percent of option ARM mortgages were in the process of foreclosure as of the third quarter 2009.[6] The Cleveland Federal Reserve Bank reveals that as of second quarter in 2009, 13 percent of FHA loans in Ohio were 60 plus days delinquent compared to 29 percent for subprime loans.[7]

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[4] Dan Immergluck, *From Minor to Major Player: The Geography of FHA Lending During the U.S. Mortgage Crisis*, Georgia Tech, December 2009, p. 6.
[5] Immergluck, p. 8.
[6] OCC and OTS Mortgage Metrics Report, Third Quarter 2009, December 2009, p. 5 available at http://www.occ.gov/ftp/release/2009-163a.pdf
[7] Lisa Nelson, Cleveland Federal Reserve Bank.

FHA lending has performed better than subprime lending most likely due to more rigorous underwriting. FHA loans were typically fixed-rate, plain vanilla loans offered to borrowers whose income was verified.[8] In contrast, a significant percentage of subprime loans had variable interest rates, high loan-to-value ratios, and did not fully document borrower income. In many cases, borrowers of subprime ARM loans were not prepared to cope with adjustments in the interest rates.

Recent data indicates that FHA loan performance should continue to improve as a result of reduction in loan risk characteristics. In their review of the 2008 Home Mortgage Disclosure Act data, the Federal Reserve Board finds that the share of FHA home purchase loans with loan-to-value (LTV) ratios exceeding 95 percent fell from 72.3 percent in 2007 to 67.4 percent in 2008. The share of FHA home purchase loans to prime borrowers (with FICO scores greater than 660) increased from 30 percent in 2007 to 50 percent in 2008. In addition, while one third of the 2007 FHA home purchase loans went to borrowers with LTVs greater than 95 percent and FICO scores below 620, this share declined to 15 percent in 2008.[9]

Before the advent of subprime lending, a fair lending concern involved the concentration of FHA loans in communities of color. When subprime lending surged, subprime lending supplanted FHA lending in minority communities. Fair lending concerns shifted to the concentration of subprime loans in minority communities. In fact, research shows that during the years of heavy subprime volumes, African-Americans and Hispanics were significantly more likely to receive subprime home purchase loans than FHA loans, after controlling for borrower and lender characteristics.[10]

Now, after the shrinkage of subprime lending, FHA lending is once again increasing substantially in minority communities. In their zip code level analysis, the Cleveland Federal Reserve Bank shows that the increase in FHA lending was correlated with a decrease in subprime lending. In contrast, there is no correlation between prime and FHA lending trends on

[8] Written Testimony of Secretary Shaun Donovan - Hearing before the House Committe on Financial Services - FY09 FHA Actuarial Report, December 2, 2009, see http://portal.hud.gov/portal/page/portal/HUD/press/testimonies/2009/2009-12-02
[9] Avery, Bhutta, et. al. in Federal Reserve HMDA article, pp. 26 & 27.
[10] Immergluck, p. 10 and 11.

a zip code level. In other words, it appears that FHA lending is substituting for the withdrawal of subprime lending on a zip code level. Immergluck finds that after controlling for a series of borrower and neighborhood characteristics, FHA lending is more likely in African-American than white neighborhoods. Moreover, in 2008, the most recent year for which HMDA data is available, more than 50 percent of home purchase loans for African-Americans and 45 percent of the loans for Hispanics were FHA compared with just 27 percent for whites, according to the Federal Reserve Board.[11]

Because FHA loans are more expensive than conventional loans, disparities by race of borrower or neighborhood raises fair lending concerns. Conventional loans with higher LTVs require private mortgage insurance, which is paid monthly just as FHA has monthly premiums. In contrast to FHA loans, however, conventional loans have no up-front premium. Also FHA loans may have higher rates or fees than conventional loans due to FHA processing requirements. Immergluck finds the average interest rate on a FHA loan to be 6.15 percent compared to a conventional rate of 5.86 percent --- 29 basis point difference.[12] FHA lending has become an important source of credit in minority communities because of the drying up of conventional credit. FHA lending, however, is more expensive than conventional loans. Fair lending investigations and enforcement need to uncover whether any redlining or avoidance by traditional banks and/or any targeting or steering by FHA lenders is causing these disparities. Increased fair lending enforcement should help bolster FHA's important role in minority communities by increasing competition among responsible FHA and conventional lenders and thus narrow the interest rate differential between FHA and conventional loans.

FHA has also had an important countercyclical and stabilizing role in economically disadvantaged communities. Immergluck shows that FHA lending is more likely in communities experiencing high unemployment, smaller metropolitan areas, metropolitan areas experiencing large home price declines, and zip codes with lower median home values. In other words, FHA lending has increased while conventional lending has decreased in communities hardest hit by the current severe recession.

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[11] Avery, Bhutta, et. al in Federal Reserve HMDA article, p. 29 and p. 56 table 16
[12] Immergluck, p. 14.

FHA has also historically been focused on low- and moderate-income (LMI) borrowers. In 2006, 11.4 percent of the home purchase loans issued to LMI borrowers were FHA loans as opposed to 2.6 percent for upper-income borrowers. By 2008, 37.6 percent of the home purchase loans issued to LMI borrowers were FHA loans as opposed to 20.6 for upper-income borrowers.[13] While the gap narrowed between LMI and upper-income borrowers, LMI borrowers still received almost twice the percentage of FHA loans as upper-income borrowers. Even in this crisis, FHA's focus is on the modest-income, first-time homebuyer that has more difficulty than their upper-income counterparts in accessing credit.

HUD's Proposed Reforms

The challenge for HUD is to improve the FHA program with tighter underwriting so that delinquency rates decline but that FHA does not retrench from the communities in most need. While FHA delinquencies are lower than subprime, they are higher than prime delinquencies. HUD's proposals seek to strike the right balance between reducing risk through tighter underwriting while still maintaining access for traditionally underserved neighborhoods.

These proposals include:

Adjustments to Up-Front Premium and Annual Premiums: Currently, HUD charges an up-front premium of 1.75 percent and annual premiums of .55 percent of the loan amount. HUD is proposing to increase the upfront premium to 2.25 percent. If HUD receives legislative authority per the draft statutory language it just sent to the House Financial Services Committee, it would reduce the upfront premium charge and increase the annual charge to as much as 1.5 percent of the loan amount. For some borrowers that do not have much cash for closing, shifting the fees to the annual premium makes the up-front premium more affordable. Other borrowers may prefer the higher upfront charge because monthly payments would be lower. It would seem that HUD should offer a menu of options regarding the upfront and annual premium charges.

[13] Federal Reserve's review of HMDA data, p. 56, Table 16A. LMI and upper-income definitions are the CRA income definitions of up to 80 percent of area median income for LMI borrowers and 120 percent or more of area median income for upper-income borrowers.

Combination of FICO scores and Downpayment Requirements: HUD proposes to require a minimum FICO score of 580 and above to qualify for a 3.5 percent downpayment. For borrowers with FICO scores below 580, the downpayment requirement would be 10 percent of the loan amount. According to HUD, the delinquency rate for borrowers with FICO scores above 580 and 3.5 percent downpayments was 7.5 percent compared to 31 percent for borrowers with FICO scores below 580 and 3.5 percent downpayments. HUD will allow the borrowers with FICO score below 580 to make a downpayment of 10 percent and receive FHA loans because HUD states that borrowers with low FICO scores but higher downpayments perform better. Given the data trends, HUD's proposal makes sense in shoring up the FHA reserves while still maintaining opportunities for borrowers with less than 580 FICO scores to receive FHA loans. It should also be noted that traditional lenders making conventional loans regard a FICO score of 620 a hard cut-off for lower downpayment loans, meaning that FHA is preserving access in the market for borrowers with imperfect credit.

Reduction of Allowable Seller Concessions: HUD is proposing to reduce allowable seller concessions from 6 percent to 3 percent. This reduction is appropriate because the higher level of seller concessions contributed to appraisal fraud and other abuses.

Indemnification by Lenders: In legislative language sent to the House Financial Services Committee (which was incorporated in the discussion draft of the FHA Reform Act of 2010), HUD is asking Congress to allow the agency to require indemnification from all lenders participating in the FHA program for acts of fraud and misrepresentation in addition to the lenders that have FHA's permission to approve loans without pre-endorsement review by the FHA. It would seem that all lenders participating in the FHA program should be on a level playing field and subject to sanctions should they engage in fraud. In addition, this change should assist FHA reduce delinquencies and defaults.

Credit Watch: HUD is proposing that Congress enact legislation providing it with flexibility in defining geographical areas for review and termination of fraudulent lenders from FHA lending under the Credit Watch initiative. This proposal makes sense in that rigidities in the current law

may allow a lender to switch unscrupulous operations from one branch to another branch just over a state border and remain as a FHA lender in those two states.

Neighborhood Watch: HUD has enhanced Neighborhood Watch that provides publicly available data on FHA loan performance in geographical areas and for individual lenders. Just like Home Mortgage Disclosure Act (HMDA) data, this publicly available FHA loan performance data holds lenders accountable.

FHA- HAMP: NCRC supports HUD's implementation of its FHA-HAMP program to assist borrowers at risk of imminent default due to loss of income. FHA-HAMP allows principal forbearance or a partial claim in the form of a subordinate mortgage that is paid off when the homeowner sells the home. HUD and the Treasury Department should increase their efforts to persuade lenders to use FHA HAMP. NCRC's counselors report that they have not experienced lenders using this program.

NCRC Recommendations

Increase the Role of Nonprofit Counselors: NCRC understands that HUD has the authority to reduce the upfront premium if the borrower receives counseling from a HUD-approved counselor. HUD, however, does not have the authority to reduce annual premium amounts if a borrower has counseling. NCRC recommends that Congress grant HUD this authority since counseling has proven to be effective and since reductions in premium amounts will assist in increasing the affordability of FHA loans for those borrowers receiving counseling.

Bolster Fair Lending Enforcement: HUD and the federal banking agencies must bolster their fair lending enforcement efforts. FHA has played an important role in preserving access to credit in this difficult economic environment. Yet, evidence suggests that when controlling for lender, borrower, and neighborhood characteristics, communities of color receive a disproportionate amount of FHA loans. FHA loans are not inherently abusive or risky like a significant amount of subprime loans. FHA loans, however, are more expensive than conventional loans. Increased fair lending enforcement would promote more competition among lenders and lower prices by

prosecuting redlining by traditional lenders and any targeting of communities by FHA lenders. HUD and the federal banking agencies should consider the use of matched pair testers in its enforcement efforts. HUD is to be commended for its renewed focus on enforcement and termination of unscrupulous lenders such as Taylor, Bean, and Whitaker from the FHA program. Matched paired testing can aid HUD in these ongoing investigations. In addition, the results of fair lending review should be made publicly available just like CRA exams in order to increase the accountability of financial institutions.

FHA and state and local programs: State and local departments of housing and community development operate a number of CDBG and HOME-funded programs that provide second mortgages and other subsidies for first-time homebuyers and other underserved segments of the community. NCRC understands that HUD allows state and local agencies to use these programs for borrowers that receive FHA loans. NCRC recommends that HUD, lenders, and other stakeholders help state and local agencies to further promote these programs. These programs increase the affordability of FHA loans.

Tax Deductibility of FHA Premiums: The Mortgage Debt Forgiveness Act made FHA premiums fully tax deductible for households with incomes under $100,000 for the years 2008 through 2010. Congress ought to make FHA premiums deductible with no time limits just like private mortgage insurance payments. Congress ought to be taking steps to make FHA affordable for borrowers unable to receive conventional loans, and extending tax deductibility is one straightforward way to do this.

Frequent Reviews of FHA Pricing and Underwriting: HUD should undertake frequent reviews of FHA pricing and underwriting criteria in order to ensure that the program is promoting both safety and soundness and access. When loan performance warrants, HUD should adjust its underwriting criteria in order to promote access to the FHA program.

Conclusion

The changes proposed by the FHA attempt to navigate a prudent course without negatively impacting access to credit or contributing to a further slowing of the housing market in communities of color. While some borrowers will bear more of the costs of the government insurance program through higher premium charges, the additional revenue will help ensure that FHA remains solvent. The burden to the individual borrower is modest and should ensure, overall, that borrowers have access to responsible credit. While some less credit worthy borrowers will need higher down payments, this is a necessary move in difficult market conditions where a decline in home value can wipe out a new buyer's equity. We believe that the FHA has a difficult path to navigate, but we think they have successfully realized three core objectives simultaneously:

- First, to reduce the financial exposure of the FHA fund through tighter credit rules;
- Second, to sustain the flow of mortgage credit sufficient to make sure the housing market doesn't go into a renewed negative spin;
- And third, to avoid "balancing the FHA books" on the backs of credit worthy working families.

FHA was created in 1934 to heal the U.S. housing market during the Great Depression and for decades – due to a stable housing market - it has turned a profit for taxpayers. Today, it is more critical than ever that FHA remain a strong gateway for responsibly underwritten credit in the communities that we serve, while also ensuring a healthy and sustainable mortgage marketplace beneficial to all.