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

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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.

[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.

<u>January Policy Announcements and Legislative Requests</u>

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.

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[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.