

## **STATEMENT OF BRIAN D. MONTGOMERY**

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“Reform of FHA’s Title I Manufactured Housing Loan Program”

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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