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on

The Administration's Report to Congress: Reforming America's Housing Finance Market

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Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify today on behalf of the Obama Administration's efforts to reform and strengthen America's system of housing finance.

I appear before you today at a time when our housing market and underlying economy continue to recover from the worst crisis since the Great Depression, while still mindful that this recovery remains fragile. We have made remarkable progress these past two years, which I will describe in greater detail below. But we must also look to the future to ensure that such a crisis never happens again – and our recent proposal for reform, *Reforming America's Housing Finance Market*, sets the stage for a robust public discussion of how we can do that. At the end of the day, the housing finance system must work for *all* American families, whether they are high or low income, owners or renters.

Before discussing the report itself, I would like to say a few words about the steps that we have taken to stabilize a fragile housing market. I will then focus on three key elements in the report. First and foremost is the Administration's commitment to housing affordability and access to mortgage credit. Second is the critical role the Administration proposes for the FHA going forward, and third is how the Administration and Congress must work together to ensure housing finance advances opportunity in every community.

Administration Efforts to Stabilize the Housing Market

Mr. Chairman, immediately upon taking office, President Obama and this Administration quickly took several steps to confront the economic crisis, including steps to stabilize a housing market that was declining rapidly with seemingly no bottom. House prices were in freefall—having fallen every month for 30 straight months before the inauguration. Home equity had been slashed in half—losing $6 trillion total—which wiped out wealth for many families. And we were losing an average of 753,000 jobs every month and were in the middle of 22 consecutive months of job losses.

With the housing market continuing to collapse and private capital in full retreat, the Administration had no choice but to take action.

Federal Reserve and Treasury Department mortgage-backed securities purchase programs helped keep mortgage interest rates at record lows, enabling many American families with equity in their homes to refinance into sustainable mortgage products at significant monthly savings. Indeed, refinancing a mortgage amortized over 30 years from 6 percent down to 4 percent cuts monthly payments by 20 percent. These savings can then be applied to other household budget needs or put away for a rainy day, a college fund, to start a new business, or for retirement.

To ensure mortgages were available at those low rates, the Administration provided critical support for Fannie Mae and Freddie Mac, which had been put into conservatorship under the Administration of George W. Bush, and FHA and Ginnie Mae stepped in to play a larger role in the home purchase and refinancing markets. As reported in the Obama Administration's February Housing Scorecard, since April 2009, more than 9.5 million homeowners have been able to refinance their mortgages to benefit from lower interest rates, saving each household an average of $140 per month or, collectively, $18.1 billion annually.

It should be noted moreover that the vast majority of losses the GSEs have incurred are from loans made prior to conservatorship. Indeed, since Fannie Mae and Freddie Mac were placed into conservatorship by the previous Administration, the FHFA has strengthened underwriting standards and adjusted pricing to better reflect risk, and key indicators show that the quality of loans they are making has improved substantially – allowing the GSEs to play an important role supporting our housing market over the last two years.

And collectively, the FHA's loss mitigation policies and the Administration's Home Affordable Modification Program (HAMP) set an example for mortgage modification efforts that the private market took too long to adopt but has finally begun to incorporate into their servicing practices. More than 4.2 million distressed borrowers have received mortgage assistance since April 2009—including HAMP modifications, FHA loss mitigation activities, and voluntary private efforts as part of the HOPE NOW alliance—more than twice the number of foreclosures completed during that time. Monthly foreclosure starts are down more than 25,000 per month from this same time one year ago. While some of this decline may be attributed to servicer process reviews that are taking place in response to the recent discovery of widespread foreclosure processing issues, we are seeing encouraging signs that fewer families are entering delinquency.

In short, our efforts are helping struggling families, their communities and the economy. Foreclosure starts are down, and, most importantly, we have seen 12 straight months of job growth in the private sector.

The Need for Reform

For all of the efforts to date, though, there is much more to do. We must continue to take steps to facilitate the return of private capital to the housing finance system in a responsible way. Last summer, Congress passed, and the President signed, sweeping financial reform legislation. Crucially, the Dodd-Frank Wall Street and Consumer Protection Act, provides vital protections for consumers and investors that will help end abusive practices in the mortgage market and improve the stability of the overall housing finance market.

In keeping with our obligations under Dodd-Frank, the Obama Administration recently delivered a report to Congress, *Reforming America's Housing Finance Market,* which provides a path forward for reforming our nation's housing finance system. The report outlines steps that will be taken to wind down Fannie Mae and Freddie Mac and help bring private capital back to the market in a first loss position. Moreover, it describes how to fix fundamental flaws in the mortgage markets and better target the government's support for a full range of housing that is affordable for its occupants, and lays out choices for longer-term reforms.

The President believes that an integral part of reforming the housing finance system must be ensuring that Americans have access to quality housing they can afford. This involves supporting a range of affordable options. For the millions of Americans who rent, this means designing a system that can consistently provide necessary financing to appropriately maintain those rental properties and support development of affordable housing opportunities in communities that provide access to decent jobs and good schools. For current and aspiring homeowners, we reaffirm our commitment to promoting sustainable homeownership predicated on safe mortgages. We continue to believe that every American who has the credit history, the financial capacity and the desire to own a home should have the opportunity to take that step—and that the private sector will continue to play a crucial role in providing fairly priced access to mortgages in all communities.

Although some have suggested Fannie and Freddie's affordability goals were solely responsible for their failure, they were not. Indeed, the vast majority of mistakes that were made—poor underwriting standards, underpriced risk, and insufficient capital with inadequate regulatory or investor oversight—mirrored those made in the private label securities market where affordability goals were simply not a factor. It was these flaws that drove the GSEs and the broader market to failure, not the affordability goals.

Nevertheless, we must recognize that the GSEs' affordable housing goals, while well intended, were not well designed. They didn't respond effectively to the needs of underserved communities and they were decidedly misaligned with mortgage origination by primary market actors. Worst of all, they failed to prevent the kind of high-cost, predatory loans which devastated countless communities and were one of the roots of the crisis.

In reforming the housing finance system, we have before us an opportunity to ensure that our efforts to provide access to mortgage credit and promote housing affordability are more effective than in the past. Those efforts must be better targeted, more transparent and more focused on providing support that is financially sustainable for families and communities alike. We must remain cognizant that secondary market activities are a significant driver of liquidity in the primary market and variations in access to mortgage finance across communities is substantively impacted by them.

The Importance of a Robust and Responsible Private Mortgage Market

FHA and the GSEs have stepped into the void left when private capital for mortgage finance dried up early in the housing crisis. They have played, and continue to play, this critical countercyclical role. But as we return to normal market function, we are committed to shrinking government's oversized footprint in the mortgage market. The government-backed share of the current mortgage market is well in excess of 90 percent, which is far higher than we would like in normal times.

Similarly, FHA alone accounts for more than 20 percent of the market – almost twice its historical norms and about seven times bigger than its share leading up to the crisis, when typical FHA borrowers were frequently convinced to take on unsustainable and often predatory products flowing through effectively unregulated channels. FHA's countercyclical activities have been critical in providing mortgage financing during the crisis. By facilitating the availability of vital liquidity through a variety of approved community banks, credit unions, and national lenders, FHA has helped over 2 million families buy a home since President Obama took office—80 percent of whom were first-time buyers. FHA has also helped nearly 1.5 million existing homeowners refinance into stable, affordable products, with monthly savings exceeding $100 on average.

FHA, along with VA and USDA, are not alone in providing liquidity for mortgages during this crisis. Nearly all non-Ginnie Mae residential mortgage-backed securities issued since the crisis began have come from the GSEs. Without them playing this role, the availability of credit for families purchasing homes during these times of economic stress would have been dramatically restricted, leading to an even more strain on the housing market.

But this level of government exposure isn't sustainable—and the time has come to begin to bring private capital back. The options we laid out in the report help us get there.

Towards a New System of Housing Finance

Bringing private capital back into the housing finance system does not mean eliminating all government involvement in housing finance. We believe that a government role, targeted correctly, and with the right protections for taxpayers, should remain an important component of any future system. That is why all three of the reform options we lay out in the white paper include a strong, resilient FHA and solid consumer and investor protections.

To that end, reforming and strengthening FHA is the first of four primary areas of reform to achieve broader mortgage access and housing affordability. The other crucial components of reform are a commitment to affordable rental housing, a flexible and transparent funding source for access and affordability initiatives, and strong measures to ensure that ensure that capital is available to creditworthy borrowers in all communities, including rural areas, economically distressed regions, and low-income communities.

A Reformed and Strengthened FHA

Within the existing authorities granted to us by Congress, we have already begun the necessary process of making changes to FHA to ensure that it will be able continue its mission. FHA has already made the most sweeping combination of reforms to credit policy, risk management, lender enforcement, and consumer protection in its history. These reforms have strengthened our financial condition and minimized risk to taxpayers, while allowing us to continue fulfilling our mission of providing responsible access to homeownership for first-time homebuyers and in underserved markets.

In the near term, we look to Congress to pass FHA reform legislation that enhances FHA's lender enforcement capabilities and risk management efforts critical to our ability to monitor lender performance and ensure compliance, among other things. Indeed, last year the House of Representatives passed an FHA reform bill, H.R. 5072, containing an array of changes along these lines, and, while similar legislation was introduced in the Senate, action on the bill was not completed. We look forward to working with both chambers of Congress to enact these proposals into law.

Longer term, we also hope to work with Congress to give FHA additional flexibility to respond to stress in the housing market and to manage its risk more effectively. This will mean giving FHA flexibility to adjust fees and programmatic parameters more nimbly than it can today. FHA should also have the technology and talent needed to run a world-class financial institution.

Strengthening and reforming FHA in a way that is healthy for its long term finances and ensures that FHA is able to continue its mission of providing access to mortgages for low- and moderate-income families is a central component of broader systemic reforms. While FHA has already changed policy to require that borrowers with lower FICO scores make larger down payments, FHA will consider other options, such as lowering the maximum loan-to-value ratio for qualifying mortgages more broadly. In considering how to apply such options, FHA will continue to balance the need to manage prudently the risk to FHA and the borrower with its efforts to ensure access to affordable loans for lower- and middle income Americans, including providing access to homeownership for first-time homebuyers and underserved markets.

And similar to the Administration's broader reform of the U.S. housing finance system, FHA will take any steps for reform carefully to ensure that they do not undermine the broader recovery of the housing market. Similarly, as we consider changes in such areas as down payments and LTV ratios, we will make sure to retain the flexibility to respond to changing market conditions, so that we are able to manage risk, and maintain access, as effectively as possible.

Some have expressed concerns that the increases to the monthly premium set to go into effect next month—on the order of $30 per month for the average borrower—and any increase in down payment requirements have the potential to excessively restrict access to credit or perpetuate a dual credit market. We believe that the benefit to the financial health of FHA of the relatively modest premium increase is appropriately balanced with the need to maintain access, as the change remains affordable for almost all homebuyers who would qualify for a new loan. Similarly, we will only pursue increases in downpayment where the impact on access is not prohibitive.

A commitment to affordable rental housing

With half of all renters spending more than a third of their income on housing—and a quarter spending more than half their income— this Administration believes that as part of a balanced housing policy there should be a range of affordable options for the millions of Americans who rent. Reducing government's role in the single family market makes this commitment even more critical.

Private credit markets have generally underserved multifamily rental properties that offer affordable rents, preferring to invest in high-end developments. By contrast, Fannie Mae and Freddie Mac developed expertise in profitably providing financing to the middle of the rental market, where housing is generally affordable to moderate-income families. As we wind down Fannie Mae and Freddie Mac, it will be critical to find ways to maintain funding to this segment of the market.

One option would be to expand FHA's capacity to support lending to the multifamily market. Utilizing existing multifamily expertise so that FHA and other entities continue the industry's current best practices and retain valuable human capital would help achieve this objective.

We will also consider a range of reforms, such as risk-sharing with private lenders to reduce the risk to FHA and the taxpayer, and developing programs dedicated to hard to reach property segments, including the smaller properties that contain one-third of all rental apartments.

Dedicated funds for targeted homeownership and rental affordability

Support for affordable housing requires consistent, flexible, and transparent funding. Although FHA and other federal affordable housing policies do a great deal to provide access and affordability, we recognize that a more balanced system will require additional resources to address clear gaps. That was the goal of the National Housing Trust Fund, which was authorized by Congress in 2008, but which has yet to receive funding. And with the largest increase in worst case housing needs in the quarter-century history of the survey – the necessity for strong support of affordable housing has never been more clear.

That is why the Administration will work with Congress on developing a new dedicated financing mechanism to support affordable homeownership and rental housing that current policies cannot adequately address. This funding stream would support the development and preservation of more affordable rental housing for the lowest-income families to address serious supply shortages. On the ownership side, it would support down-payment assistance, counseling, or other mechanisms to help qualified low and moderate-income homebuyers, in a form that does not expose them or financial institutions to excessive risk or cost.

The funds could be used to scale up support for proven nonprofit partnerships for affordable housing production and preservation that can attract much larger amounts of private capital. This is the purpose of the Capital Magnet Fund, also enacted in 2008 and funded in FY 2010 as a pilot demonstration administered by the Treasury Department's Community Development Financial Institutions Fund. And funding would help to overcome market failures that make it hard to develop a secondary market for targeted affordable housing mortgages, such as that for small rental properties.

These components target specific needs in flexible ways that can engage a range of partners and respond to local priorities and opportunities. We will work with Congress to ensure that funding will be transparent and targeted to clearly defined objectives and programs.

Ensuring that capital is available to creditworthy borrowers in all communities

Last, housing finance reform must include measures to ensure that capital is available to creditworthy borrowers in all communities, including rural areas, economically distressed regions, and low-income communities. Our plan calls for greater transparency that requires secondary market actors to disclose information on the credit, geographic, and demographic characteristics of the loans they package into securities. In addition to benefits for investors, greater transparency allows us know who is abiding by fair lending and equal credit obligations—and who's not.

A key lesson from this crisis is that decisions made in the secondary market very clearly drive lending practices in the primary market—and the potential for disparate impact in the availability and quality of mortgages in underserved communities is very real.

To that end the Administration is fully committed to exploring other measures to make sure that secondary market participants are providing capital to all communities in ways that reflect activity in the private market, consistent with their obligations of safety and soundness.

Long-term Options

Beyond the key foundations of a new, reformed housing finance system based on the principles discussed above, the extent of any government guarantee in the system has yet to be determined – and our report presents three options. While I would refer the committee to the report itself for a detailed discussion of the advantages and drawbacks of each, I would note that the issue most likely to impact American families is the question of the availability and pricing of long-term, fixed-rate financing under each of the options. For decades, the 30-year, fixed rate mortgage has allowed families to safely build wealth and climb the ladder to the middle-class. So as we consider the options for a future housing finance system, I believe we should consider carefully the implications of these choices on the availability and pricing of those mortgages.

In all of these options, however, a reformed and strengthened FHA remains an important participant in the market. This Administration believes there continues to be an important role for government in ensuring access to mortgage credit and housing affordability – one that incorporates lessons learned from the past. We will continue to ensure that creditworthy low- and moderate-income borrowers have access to affordable mortgages.

Winning the Future Starts at Home

Ultimately, Mr. Chairman, this plan is about bringing private capital back into a healthier housing finance system and providing a balanced national housing policy that offers all Americans the choices in housing that make sense for them and for their families. Whether it is rental options near good schools and good jobs, access to credit for those in a position for sustainable homeownership, or assistance for those who feel the strain of high housing costs, the housing finance system must meet their needs, and we look forward to working with Congress to make it happen.

The more the American people can participate in this debate, expanding beyond necessary discussions of capital markets, G-fees, risk-based capital, and mortgage-backed securities to express equally necessary consideration of how essential the system is to the futures of their own families and communities—the better system we'll build, the stronger our country will be, and the more opportunity we'll be able to provide every American. Thank you.