Testimony of Benjamin S. Carson, Sr.
Secretary of Housing and Urban Development

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Chairman Crapo, Ranking Member Brown, and members of the Committee, thank you for the opportunity to appear before you today to discuss how the U.S. Department of Housing and Urban Development (HUD) will support this Administration's effort to reform the nation's housing finance system.

In the years since the financial crisis, the Federal Government has continued to play an outsized role in the nation's housing finance system, and it is imperative Congress acts with the Administration to refocus Federal agencies insuring and guaranteeing mortgages to their core role of supporting equity and wealth building through sustainable homeownership and ensuring these government programs do not overlap with, and crowd out, fully private capital in the conventional mortgage market.

To this end, I am pleased to present an overview of HUD's housing finance reform (HFR) plan that was submitted to the President on September 5, 2019. Housing finance reform is a key priority of this Administration, and as recognized in the March 27, 2019 Presidential Memorandum on Federal Housing Finance Reform (Presidential Memorandum), it is crucial to advance reforms that acknowledge the integral role HUD plays in the nation's housing finance system.

HUD supports millions with affordable housing opportunities through its rental assistance and manufactured housing programs, and the Federal Housing Administration (FHA) and Government National Mortgage Association (GNMA) provide credit access and liquidity in the mortgage market. FHA provides credit enhancement and regulatory oversight for a portfolio exceeding $1.4 trillion, and importantly serves as a countercyclical buffer during times of stress, and GNMA guarantees more than $2 trillion in mortgage-backed securities (MBS) with the full faith and credit of the United States of America, facilitating liquidity in the housing market and contributing to the availability of mortgage credit for qualified borrowers.

During the financial crisis, and because of the policies of the previous Administration, FHA's and GNMA's balance sheets swelled, growing by approximately 350 percent and 400 percent, respectively, between fiscal years (FY) 2007 and 2018. Federal policymakers should take steps to enable both FHA and GNMA to refocus on their core missions and make sure both agencies have the tools needed to manage their significant portfolios, strengthening their ability to support the housing market and minimizing the likelihood of any future taxpayer funded bailout.

Reform will reduce the Federal Government's outsized role in housing finance and prevent its activities from crowding out the private sector. Congress must work with the Administration to: refocus FHA to its core mission of serving low- and moderate-income families, including first-time homebuyers (FTHBs), that cannot be fulfilled through traditional underwriting; protect American taxpayers from bailouts; provide FHA and GNMA with the tools they need to manage risk of their oversized portfolios; and provide liquidity to the housing finance system.

Pillar I: Refocus FHA to its Core Mission

Targeting Programs to Borrowers Not Served by Traditional Underwriting

The Presidential Memorandum directed HUD to recommend reforms that would allow FHA to best target its programs to borrowers not served by traditional underwriting. Historically, this has been FHA's most important contribution to the American housing market: facilitating earlier entry points into homeownership for these families, particularly FTHBs, than conventional mortgage loans with higher downpayment requirements. Without FHA mortgage insurance, many of the low- and moderate-income, minority, and FTHBs supported through the agency's programs would lack access to affordable mortgage credit. In recent years, in the aftermath of the financial crisis, the share of FHA-insured purchase mortgage activity for FTHBs has ranged between 75 percent and 83 percent of total annual purchase loan endorsements.

Refocusing on the core mission will strengthen FHA's ability to help creditworthy borrowers build equity, avoid foreclosure, and protect taxpayers. The benchmark for success of FHA's programs should be ensuring that borrowers are receiving financing that is appropriate, sustainable, and optimized for long-term homeownership. To this end, HUD has proposed the implementation of a "Homebuyer Sustainability Scorecard" (Scorecard) that would be used by FHA to measure the performance of loans to low- and moderate-income borrowers and FTHBs. The Scorecard will track the percent of mission borrowers who default, return to renting, refinance out of an FHA loan, remain in an original FHA-financed home, and monitor the risk associated with secondary financing (i.e., downpayment assistance (DPA)). Moreover, FHA will use the Scorecard to evaluate additional underwriting criteria to ensure that new lending within its single-family portfolio remains consistent with FHA's mission. With the Scorecard, FHA will change the measure of success by no longer touting the number of loans it insures and instead, as with other HUD programs, tracking whether its borrower participants are improving with FHA support.

It is also important FHA support sustainable homeownership; which FHA can support in part through mortgage products that carry terms that accelerate equity accumulation. After all, faster accumulation of equity benefits borrowers. To achieve this objective, HUD's plan recommends FHA undertake the following reforms: 1) conduct rulemaking to clarify the statutory prohibitions on DPA providers that financially benefit from a mortgage transaction; 2) examine incentives to make shorter-term mortgages that accelerate equity accumulation more attractive to FHA's mission borrowers; 3) ensure the agency's programs and policies do not incentivize negative borrower behavior such as equity stripping via cash-out refinances; and 4) examine the overall impact of repeat borrowers on the Mutual Mortgage Insurance Fund (MMIF) and ensure these loans are consistent with the agency's mission.

Define Roles for Government-Supported Programs through Better Coordination

A central principle of the Administration's HFR plan is that Federal mortgage credit policies should be better coordinated in order to allow qualified borrowers to access responsible and affordable options. Coordination ensures that there is not unhealthy and irresponsible competition between government-supported programs, which can lead to lower underwriting standards, increase risk to taxpayers, and threaten the long-term availability of credit to qualified borrowers. The government-sponsored enterprises (GSE), which back a substantial portion of the nation's mortgage debt, should not be able to selectively choose from the FHA portfolio and leave taxpayers with the riskiest borrowers.

Uncoordinated policies create incentives that encourage entities to work at cross-purposes, resulting in little or no change in overall access to credit while increasing taxpayer exposure to uncompensated risk. As discussed in HUD's plan, the FHA program is primarily utilized by FTHBs who cannot be served through traditional underwriting, as it generally accepts more risk and provides low downpayment borrowers greater leverage than allowable in GSE programs while also offering government-subsidized pricing.

As proposed in our plan, FHA and FHFA will coordinate to ensure that the GSEs and FHA serve defined roles within the marketplace. HUD and FHFA should develop and implement a specific understanding as to the appropriate roles and overlap between the GSEs and FHA, for example, with respect to cash-out refinances, conventional-to-FHA refinances, and loans to FHA repeat borrowers. Moreover, HUD has recommended that Congress establish FHA, the Department of Veterans Affairs (VA), and the Department of Agriculture (USDA) – the government-insured mortgage loan programs – as the sole source of low downpayment financing for borrowers not served by the conventional mortgage market.

Provide Regulatory Certainty to FHA Lenders

FHA strives to be clear in its guidance on compliance and legal enforcement matters and will not tolerate violations of its program – those who seek to defraud borrowers and taxpayers, as well as those who make routine (and often material) errors that put strain on the agency's resources. Additionally, FHA makes it a top priority to adhere to the rule of law, and this means the agency's view of materiality should be clearly communicated.

FHA participants and advocacy groups have called for clarification of the process by which HUD and the Department of Justice (DOJ) consider whether severe financial penalties through the pursuit of False Claims Act (FCA) remedies is appropriate for minor and putatively immaterial errors. HUD will prioritize improving certifications to which lenders attest for each FHA-insured loan, as well as lenders' annual certifications. These certifications, along with updates to FHA's defect taxonomy in order to clearly align the severity of loan underwriting defects with proposed remedies, will provide the needed certainty and clarity on FHA's requirements. HUD also will ensure its views of materiality with respect to potential violations of the FCA are clearly shared through formal consultation with DOJ.

Pillar II: Protect American Taxpayers

Strengthen FHA Risk Management Systems and Governance

With mortgage insurance on loans over $1.4 trillion in unpaid principal balance (UPB) and more than $2 trillion in MBS guaranteed by taxpayers, FHA and GNMA, respectively, must ensure their business and operational practices protect American taxpayers. Meeting this duty also is essential to both agency's respective missions, and if either does not operate in a fiscally responsible manner, HUD's ability to provide affordable and sustainable mortgage credit for borrowers is severely jeopardized. FHA must maintain an appropriate level of capital reserves in the MMIF, and it is unacceptable for the agency to ever again require a draw on taxpayer funds to sustain its book of business, as it did in the previous Administration. Thus, FHA should strengthen its governance and build its capital ratio well above the statutory two percent minimum safeguarding the agency against episodes of market distress.

To ensure protection of the American taxpayer, modernizing FHA risk management capabilities is critical. As the size of FHA's portfolio has not returned to pre-crisis levels and taxpayers continue to bear increased risk, now is an appropriate time to develop and implement a framework that will better allow the agency to monitor current, emerging, and future risks across credit cycles.

To accomplish these risk management objectives, HUD has proposed the following key reforms: a sound risk-based capital regime framework, credit-risk sharing capability, in addition to inter-agency coordination on credit policy and counterparty information exchange. First, HUD's plan recommends that Congress direct the Department to formally evaluate options, feasibility, and the economics of a credit-risk transfer (CRT) program similar to those recently implemented by the GSEs—these programs could be effective ways for FHA to reduce the overall risk to taxpayers in FHA's mortgage insurance programs while still serving HUD's mission borrowers. Second, HUD proposes that Congress also direct FHA to more effectively manage lender counterparty risk in future books by authorizing such additional remedies as appropriate. HUD has further proposed FHA adopt sound risk-based capital regimes for both the MMIF and the General Insurance/Special Risk Insurance (GI/SRI) Fund, managing risk exposure to defined stressed scenarios and ensure that FHA does not inappropriately compete with the GSEs or private capital. Last, HUD recommends FHA pursue an inter-agency agreement with other government agencies (including GNMA and FHFA) involved in mortgage insurance and mortgage securitization on counterparty risks.

Improve Financial Viability of the Home Equity Conversion Mortgage (HECM) Program

The HECM program, which has supported millions of American seniors to "age in place," has suffered significant financial distress in recent years. At the end of FY 2018, FHA's HECM portfolio had an economic net worth of negative $13.63 billion and a standalone capital ratio of negative 18.83 percent. Financial volatility within the HECM program remains a constant challenge for FHA, despite changes to the program's principal limit factors and insurance premiums in 2017, and the implementation of an appraisal inflation risk mitigation policy in 2018, both of which have been directionally positive on the program's fiscal solvency.

To continue shoring up the HECM program and best ensure these mortgage products remain a viable option for America's seniors that desire to "age in place," HUD has proposed several key reforms. First, HUD recommends Congress reform the loan limit structure in the HECM program to reflect variation in local housing markets and regional economies across the U.S. instead of the current national loan limit set to the level of high-cost markets in the forward program ($726,525 for calendar year 2019). Second, HUD proposes Congress set a separate HECM capital reserve ratio and remove HECMs as obligations to the MMIF—reforms that would provide for a more transparent accounting of the program costs and decrease the cross-subsidization that occurs with mission borrowers in the forward mortgage portfolio. Third, HUD proposes FHA eliminate HECM-to-HECM refinances as these loan transactions result in greater appraisal inflation, increasing program costs, and negatively impacting GNMA-guaranteed HECM MBS (HMBS) due to quick "churn" in pool participations.

Eliminating Regulatory Barriers to Affordable Housing Including Manufactured Housing

Homeownership is a vehicle for many families to put down roots, become active in their communities, and build wealth for future generations. However, overregulation of housing construction has been a key factor in supply failing to keep pace with growing demand, resulting in many creditworthy FTHBs unable to afford the purchase of entry-level housing. On June 25, 2019, the President continued his historic deregulation campaign by signing an Executive Order establishing the White House Council on Eliminating Regulatory Barriers to Affordable Housing (Council). As the Chairman of this Council, I will build on the President's commitment to hardworking Americans by reducing overly burdensome regulations that artificially raise the cost of housing development that directly lead to the undersupply of affordable housing and will engage with state, local, and tribal partners to help them do the same.

Manufactured housing comprises 9.5 percent of the total single-family housing stock and, along with other innovative housing solutions, plays a vital role in meeting the nation's affordable housing needs. Policies that exclude or disincentivize the utilization of innovative housing construction homes can exacerbate housing affordability challenges because this kind of housing potentially offers a more affordable alternative to traditional site-built housing without compromising building safety and quality.

HUD will elevate the Office of Manufactured Housing Programs and appoint a Deputy Assistant Secretary to lead it and other innovations in housing. FHA also will consider innovative proposals to modify single-family housing mortgage finance underwriting to further stimulate additional supply of entry-level housing, including manufactured housing. To encourage innovation in manufactured housing, HUD will create a formal framework for identifying and evaluating new building, construction, and design developments and ensuring that HUD's regulations do not unnecessarily impede their adoption.

Pillar III: Provide FHA and GNMA the Tools to Appropriately Manage Risk

Today, FHA is responsible for managing a $1.4 trillion mortgage insurance portfolio with a fiduciary duty to protect taxpayers from costly bailouts. To fulfill this duty to taxpayers and ensure it continues to provide affordable access to mortgage credit for mission-focused borrowers, FHA needs some independence from broader HUD protocols that govern staffing, procurement and information technology (IT). To this end, HUD recommends that Congress enact legislation that would restructure FHA as an autonomous government-owned corporation within HUD. Moreover, to the extent administrative reforms are insufficient to address the procurement challenges at FHA (and GNMA), HUD proposes that Congress provide new statutory acquisition authorities for the Department, particularly to address instances where material underperformance of contracting vendors results in substantial quality deficiencies and costs.

FHA also continues to operate on antiquated technology platforms that inhibit the agency's ability to appropriately manage risk and fulfill its fiduciary duty to taxpayers. FHA has already developed a detailed technology roadmap that will guide the development of a single platform and baseline architecture to cover all aspects of the mortgage process, from loan origination, through endorsement, servicing, claims, and, as required, disposition. Overall, the investment in the new single platform structure will allow FHA to better adapt to changing industry, regulatory, and statutory requirements; the modernized systems will be data-driven, and ultimately allow FHA to fully digitize the mortgage process, opening doors to significantly more refined risk analysis and management. To this end, HUD has recommended that FHA explore agreements to share technology with GNMA and other government-supported mortgage programs, including the GSEs, when feasible. Additionally, HUD recommends that Congress appropriate sufficient funds for FHA to complete its multi-year, single-family IT modernization effort.

Pillar IV: Provide Liquidity to the Housing Finance System

Following the financial crisis, GNMA's outstanding MBS guaranty portfolio swelled nearly fourfold to over $2 trillion. This substantial growth in GNMA's guaranty portfolio has been concurrent with the increase in the combined mortgage insurance and guaranty programs of FHA and VA. Then, as now, GNMA has been able to effectuate its mission because of the full faith and credit guaranty of the Federal Government.

The GNMA guaranty provides for the timely payment of pass-through income (generally principal and interest) to security holders of GNMA-guaranteed MBS backed by pools of mortgages insured or guaranteed by Federal agencies, including FHA, VA, and USDA. The "last position" guaranty in mortgage securitization that GNMA covers in its MBS guaranty program is an important element of potential reform of the broader housing finance system. As described in the U.S. Department of the Treasury's HFR report, and also pursuant to the Presidential Memorandum, GNMA could—if authorized by Congress—extend its explicit guaranty to MBS backed by conventional single family and multifamily housing mortgages, as it has already gained the experience of administering, and managing the growth of, its MBS-guaranty portfolios.

In addition to this potential future role for GNMA in the nation's housing finance system, HUD has recommended that Congress pass legislation granting the agency the authority to administratively adjust its guaranty fee within a narrow, permissible range. This guaranty fee provides the funds from which losses would be paid if GNMA needed to step in to remit funds to security-holders as the result of an issuer's failure to do so. GNMA believes that the authority to administratively adjust its guaranty fee within a narrow, permissible range, would ensure that such fees are adequate for the risks in the program and sufficient for GNMA to meets its statutory obligations under extreme circumstances.

Conclusion

The Presidential Memorandum provides an opportunity for Congress and the Administration to ensure FHA and GNMA serve their important missions effectively, responsibly, and sustainably while taking care to minimize overlap in the nation's housing finance system. FHA should focus on helping its core mission borrowers become sustainable homeowners while minimizing risk to the taxpayer to the greatest extent possible and providing a path for borrowers to graduate from government-supported programs. HUD continues to work on administrative reforms absent legislation so that FHA and GNMA better serve low- and moderate-income borrowers unable to access conventional financing, but Congress must join efforts in improving these agencies' service of this critical segment of the market. For too long FHA and GNMA have operated somewhat isolated from the rest of the housing finance system and I welcome Congress's participation as this Administration reforms the agencies to better fulfill their responsibilities to borrowers and the American taxpayers.