Written Statement of

the Manufactured Housing Institute

and the

Manufactured Housing Association for Regulatory Reform

Hearing on the Federal Housing Administration's Title I Manufactured Housing Loan Program

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Before the

Subcommittee on Housing and Transportation of the Senate Banking, Housing and Urban Affairs Committee

April 4, 2006

Introduction

Chairman Allard and members of the housing subcommittee, my name is Kevin Clayton. I am the President and Chief Executive Officer of Clayton Homes, Inc. which is headquartered in Maryville, Tennessee. We are a national, vertically integrated modular and manufactured housing company owned by Berkshire Hathaway. Through our family of brands, we build, sell, finance, lease, and insure a full spectrum of affordable housing. Since 1972 we have been successfully originating and servicing manufactured homes loans, including FHA Title I loans. I am here today representing both the Manufactured Housing Institute (MHI) and the Manufactured Housing Association for Regulatory Reform (MHARR). Today's manufactured homes have evolved dramatically over the past decade with home designs and floor plans that appeal to a growing number of American families. I respectfully request that this written statement be made part of the official hearing record.

It is an honor to appear before you today to testify in strong support of S. 2123, the "FHA Manufactured Housing Loan Modernization Act of 2005." This bill was introduced by Subcommittee Chairman Wayne Allard who was joined by full committee members Evan Bayh and Mel Martinez as original co-sponsors. S. 2123 represents a bi-partisan effort to reform an important affordable housing program. The FHA Title I mortgage insurance program insures loans made by private lenders to finance the purchase of manufactured homes that will be placed primarily in land-lease communities or private land. This program is targeted to benefit lower income homebuyers to find adequate affordable housing who are particularly challenged with escalating material prices.

Background

The manufactured housing industry has gone from 376,000 building starts in 1998 to approximately 145,000 in 2005. This represents a sixty percent (60%) decline in housing shipments and sales. The primary cause for this market contraction has been the loss of available financing for potential homeowners who apply for a manufactured housing loan. As a result, the industry has not been able to serve the housing needs of individuals and families of low-to moderate-income who want to purchase a home without the encumbrance of land or real estate.

In the past, when credit availability became curtailed, the FHA Title I program provided much needed liquidity. In recent years, however, FHA Title I has not functioned as an "automatic stabilizer in the marketplace. During the early 90's, Title I insured over 30,000 loans per year. In each of the past three years, FHA Title I insured less than 10% of that amount, or less than two thousand (2000) manufactured home loans per year. While Fannie and Freddie are permitted under their charters to purchase and to create a secondary market for "home-only" loans, both GSEs have not done so to date. The sole secondary market participant for Title I loans is the Government National Mortgage Association (Ginnie Mae). As described below, Ginnie Mae's participation in this market has been extremely limited in recent years.

Ginnie Mae, which facilitates the securitization of FHA loans, attributes the decline of Title I activity to certain "structural problems" which make it very difficult for it to recoup its losses when lenders go out of business. This does not happen with FHA Title II (real property) loans because under that program, insurance is set on a loan-by loan basis. Ginnie Mae officials have stated that if these structural problems (especially the insurance issue) can be addressed as submitted within, they would end the moratorium on certifying new lenders and would help facilitate the securitization of more Title I loans. This would add much needed liquidity to the program.

Current System

The existing loan limits are set by statute and have not been increased since 1992. Ninety-five percent of the loans insured under Title I are "home only" transactions. Such loans are also commonly referred to as personal property or chattel loans.

The current loan limit set by Congress in 1992 for "home only" loans is $48,600. This amount is woefully inadequate to meet the average loan needed to purchase a manufactured home and it remains one of the primary reasons for the recent inactivity in the Title I program. The current loan threshold would limit home buyers to a single-section manufactured home which, on average, would be less than 1000 square feet in living space and lack many of today's aesthetic improvements to manufactured housing. Such cramped living quarters are hardly conducive to family living.

One of the bill's purposes is to move the current weak and inefficient Title I insurance system for manufactured housing toward the stronger and more mainstream Title II insurance system. One of the weaknesses of the current system is that the underwriting standards are very vague and leave too much discretion to individual lenders. FHA does not review lender underwriting today--the insurance is automatic with few financial safeguards. The insurance premiums are also too low which further exacerbates the fiscal soundness of this program.

Another weakness is that, unlike Title II where every loan is fully insured, under Title I FHA maintains a separate account for each lender for future claims equal to 10% of the principle balance of all Title I loans that lender originates. For example, if a lender originates $1 million in Title I manufactured home loans, only $100,000 is insured by FHA — the remaining $900,000 in not covered. Once that account becomes depleted due to foreclosures and insurance payouts, there is no insurance coverage remaining to pay future claims for loans that particular lender had originated. If additional loans end up in foreclosure and if the lender has inadequate loan reserves, Ginnie Mae (which guarantees the timely payment of principal and interest to investors) must compensate investors for principle and interest payments owed to them. During the 1990s, this insurance system created large losses for Ginnie Mae and resulted in it refusing to issue certificates ("eagles") to all but three manufactured housing lenders.

Proposed System

The new system proposed under S. 2123 would require that each loan be insured separately, as with Title II today. The bill would also institute a new system of financial "belts and suspenders" whose purpose is to provide a negative credit subsidy for taxpayers, which the legislation mandates. Specifically, the bill would: require HUD to increase the upfront insurance premium and address underwriting standards; strengthen down payment requirements; increase lender capital requirements; and maintain the current requirement that lenders co-insure 10% of each insurance loss. The current lender "account system" would disappear and each loan would be insured by FHA, similar to the Title II program today.

Under S. 2123, each party to the transaction would be responsible and held accountable for loan performance: the borrower would be required, of course, to keep monthly payments current; HUD would be responsible for increasing insurance premiums and addressing underwriting standards as market conditions dictate; and the lender would be accountable for 10% of the losses on loan defaults.

As mentioned, the loan limits have not been increased since 1992. S. 2123 would remedy this by instituting a one-time loan limit increase of 40% pegged to the current limits. While this might sound like a large increase, in reality it is not when you take into account the fact that production costs for the construction of manufactured homes have increased by over 50% since 1992. The new loan limits would be indexed for inflation going forward under the same consumer price index (CPI) used for other FHA programs.

The sum total of these reforms would result in lower-income families across the country being able to utilize the Title I program to purchase larger homes. In addition, the new financial safeguards will allow FHA to insure every loan. This should increase Ginnie Mae participation with more lenders being certified to issue Ginnie Mae securities. More securitizations would open up the secondary market for these loans – hopefully adding much needed liquidity and resulting in lower interest rates and fees. The ultimate beneficiaries, of course, would be low- and moderate-income homebuyers who will be able to enjoy more living space at a lower cost of financing.

Independent Studies In Support of Reform

Over the course of the past four years, four independent housing studies have been performed which address manufactured housing – all of which support reform of the Title I program. Three of the reports focus exclusively on manufactured housing, and two reports focus entirely on FHA Title I. The relevant pages from these reports have been provided to the subcommittee electronically as appendices to this written statement. I will briefly describe each report and its relevant findings below.

The Millennial Housing Commission was a statutory bi-partisan commission established by Congress in 2000. The commission was charged with examining, analyzing and exploring affordable housing programs in the US and how they might be improved going forward. It submitted its report to this committee in May 2002, as well as to the House Financial Services Committee and to the House and Senate Appropriations Committees. The recommendations contained in this report have served as a blueprint for housing legislation considered by Congress in subsequent years.

The report specifically covers the credit crunch currently prevalent in the financing of manufactured homes on leased land. On page 81 of the report, the Commission highlights the problem and recommends that "FHA's Title I and II programs be promoted and loan limits be increased; and Ginnie Mae approve more lenders as issuers/servicers, or instruct current issuers to make and service loans for manufactured homes". S. 2123 embodies the recommendations made in the Millennial Housing Commission report.

Later in 2002, the Neighborhood Reinvestment Corporation in collaboration with the Joint Center for Housing Studies at Harvard University issued a report to the Ford Foundation. The report, dated September 2002, was entitled

“Manufactured Housing as a Community-and Asset Building Strategy”. One of the authors of this report is former FHA Commissioner William Apgar, Senior Scholar of the Joint Center for Housing. Mr. Apgar served as HUD’s FHA Commissioner from 1997-2001 and has a unique perspective of the FHA Title I program as its former regulator.

The Ford Foundation report points out that unlike the beneficiaries of multifamily programs, owners of manufactured homes who do not own the land upon which the home sits do in fact build home equity and accumulate wealth. This is due to basic principle pay down in their monthly payments. These homeowners also benefit from homeownership tax breaks---mortgage interest deductions and property tax deductions—which are not available to renters. These factors are pointed out on page 9 of the report under the heading "Affordable Rental Housing".

Not surprisingly, the report mentions that land ownership is a key driver of home price appreciation. However, it goes on to say (top of page 9) that “the absence of land acquisition costs makes manufactured housing on leased land an affordable home ownership option to lower-income people.” The report notes that increased privacy, greater access to land, and reduced financing costs make owning a manufactured home on leased land a reasonable alternative to multifamily housing for lower income families. Under the heading "Limited Sources of Mortgage Capital" found on page 14, the report states that "FHA and

HUD need to allocate more staff and resources to explore options for supporting this segment (i.e. FHA Title I) of home ownership". S. 2123 embodies the recommendations made in the Ford Foundation report.

In 2003, HUD began to explore reform of the Title I program. In an effort to research both the need and the methods to reform the program, it retained the services of an outside contractor, Frontline Systems Inc., to prepare a comprehensive program analysis. Frontline Systems submitted its report to HUD entitled “FHA Final Title I Business Process Improvement Report” in June 2003. This report found that the Title I program was in dire need of modernization and made several policy and operational recommendations to HUD including: raising the Title I loan limits; modifying current underwriting guidelines; changing the insurance structure to the Title II insurance model; and increasing lender participation. S. 2123 embodies these specific recommendations made in the Frontline Systems report.

As a follow-up to the Frontline Systems report, in 2004 HUD contracted for a second Title I study with another outside contractor, Information Engineering Services Inc (“IES”). This study was intended to drill down and build upon the Frontline Systems report by suggesting additional statutory, regulatory, and administrative (handbook) recommendations. IES submitted its report to HUD entitled “Title I Program Findings and Recommendations” in July 2005. Consistent with the findings of the earlier Frontline Systems report, the IES report made several recommendations for reform and modernization of the Title I program. These recommendations include: changing the existing insurance structure to mimic the Title II structure; raising the loan limits and tying future increases to CPI; modifying underwriting standards; and updating the perception of manufactured housing and understanding the role it plays in affordable housing. S. 2123 embodies specific recommendations suggested in the IES report.

All four reports outlined above not only make the case for Title I reform, but each report contained specific suggestions for improving this program. As pointed out, S. 2123 is not an original body of thought. Rather, it contains the suggestions of independent public policy experts, academics, former Members of Congress and federal housing regulators who have studied this program and have concluded it is in dire need of reform.

Conclusion

As members of this subcommittee are well aware, the homeownership affordability crisis in the United States has reached epic proportions in recent years. Land appreciation has driven homeownership beyond the reach of countless low- and moderate-income homebuyers across the country. While the FHA Title I program is largely immune from these problems due to the absence of land from typical transactions, it is subject to problems of a different sort. The outdated insurance structure, inadequate financial controls, and artificially low loan limits have all conspired to atrophy this program.

Congress, working together with HUD and the manufactured housing industry must reform this much needed program now. Material prices for home building have increased more than 20% in the past five years while the loan limits have remained unchanged since 1992. Implementing the necessary reforms outlined above will give lower income homebuyers the opportunity to enjoy one of the most efficient forms of housing available today.

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