U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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Thank you, Chairman Johnson and Ranking Member Crapo, for this opportunity to discuss the proposed FHA Solvency Act of 2013. First, I would like to thank the Committee, particularly the Chairman, Ranking Member and their staffs, for all their hard work on this bill. This effort addresses many longstanding legislative requests of the Federal Housing Administration (FHA) in an evenhanded and forward-looking manner. The Secretary and I greatly appreciate the introduction of a bipartisan bill that will give HUD the tools to ensure a fiscally sound and vibrant FHA continues to support responsible homeownership and affordable housing for generations to come. We look forward to working with the Committee to help FHA better respond to current and future challenges.

As the Administration has said consistently, a strong FHA is vital to the success of our nation's housing market and critical to its ongoing recovery. As we see signs of recovery, this bill represents an important step forward, turning our collective focus away from responding to the immediate crisis to strengthening the market by applying lessons learned from that experience and giving FHA the necessary tools to better protect the Fund and the market in the future.

Historically, FHA's role has been to provide access to mortgage credit for creditworthy borrowers not otherwise served by the market and play a necessary countercyclical role during times of economic stress. As recently as my testimony before your colleagues on the Senate Appropriations committee in May, I have articulated the steps we have taken, and continue to take, to ensure that FHA, and particularly the MMI Fund, would be able to continue to play that role in a responsible fashion while reducing risk to taxpayers and borrowers alike. I can now report that these steps have had a significant positive impact on the fund, and that major indicators show strong, encouraging trends. However, our work is far from finished and we look forward to partnering with this Committee to ensure that these trends continue.

Changes to FHA Already Resulting in Positive Trends

FHA, along with the Government National Mortgage Association (GNMA), continues to have a significant impact on the nation's housing market and economic recovery. The activities of the Federal Government are critical to both supporting the market in the short term and providing access to homeownership opportunities over the long term, and doing both in a way that minimizes risks to taxpayers.

As has been true throughout its history, FHA is particularly important to borrowers that the conventional market does not adequately serve, including qualified first time homebuyers and minority borrowers who historically have been underserved. According to the latest Home Mortgage Disclosure Act data, half of all African Americans and forty-nine percent of Hispanics who purchased a home in 2011 did so with FHA insured financing. Seventy-eight percent of the home-purchase loans insured by FHA go to first time homebuyers.

Despite ongoing stress from legacy loans, FHA has made significant progress and is on a positive trajectory moving forward as a result of numerous policy changes by this Administration. The housing market, and thus the performance of the Mutual Mortgage Insurance (MMI) Fund, is closely linked to the state of the economy and improvements in the housing market combined with these policy changes have placed FHA in a stronger position.

Recently implemented changes continue to have their desired effects – improving loss mitigation, increasing recoveries and decreasing FHA's share of the market. Of the changes made since 2009, FHA's lender oversight and credit policies have yielded substantial improvements in the quality of new loans endorsed by FHA, and premium flexibility given to us by Congress has allowed us to price appropriately for future risk. Today, our newest books of forward loan originations are the most profitable in Agency history.

Improving Loss Mitigation and Increasing Recoveries

FHA has always had mandatory loss mitigation requirements for its lenders, designed to protect borrowers and taxpayers alike, but we implemented substantial improvements in recent years to enhance the effectiveness of this program. Serious delinquencies continue to fall, declining from 9.59 percent in December 2012 to 8.27 percent in May 2013. Based on data from April 2013, cures – loans that re-perform – are surpassing new serious delinquencies. Our efforts to provide effective and efficient loss mitigation, in combination with improving economic conditions, are working – reducing loses to the Fund.

A Mortgagee Letter published on November 16, 2012, outlined changes to FHA's loss mitigation home retention options. One of the key elements of this update was moving FHA's Home Affordable Modification Program (HAMP) product up in FHA's loss mitigation waterfall so servicers could more quickly offer deeper payment relief to struggling FHA borrowers, resulting in an increase in the number of borrowers being able to retain their homes. FHA has also targeted deeper levels of payment relief for borrowers earlier in the delinquency cycle and provided greater clarity for servicers.

In addition to improving FHA loss mitigation procedures, housing counseling plays an important role in reducing losses to the Fund. A 2011 study by the Urban Institute revealed that borrowers counseled by HUD-approved agencies through the National Foreclosure Counseling Mitigation program were 89 percent more likely to receive a modification cure compared to similar, non-counseled borrowers. In addition, counseled homeowners were at least 67 percent more likely to remain current on their mortgage nine months after receiving a loan modification cure. HUD-approved housing counseling agencies provided foreclosure prevention services to 774,000 families in fiscal year 2012. Looking forward, the Homeowners Armed With Knowledge (HAWK) initiative seeks ways to embed housing counseling in FHA origination and servicing in order to reduce losses to the MMI Fund and improve household economic and social well-being.

Although FHA is deeply committed to providing loss mitigation alternatives to borrowers which permit them to retain their homes, home retention is simply not an option for some borrowers. For these borrowers, pre-foreclosure sales, also called short sales, offer an opportunity to transition out of their homes. This enables both FHA and borrowers to avoid the costs and damage of the foreclosure process. Just this month, FHA introduced a streamlined pre-foreclosure sale policy which removes certain barriers for borrowers in obtaining a short sale on an FHA-insured mortgage. Because losses from short-sales are substantially lower than from the traditional FHA Real Estate Owned (REO) process, the shift of greater numbers of distressed homeowners to short-sale dispositions rather than foreclosures is anticipated to yield better results for the MMI Fund while allowing distressed borrowers to start anew without having to go through the difficult and costly foreclosure process.

Throughout the past fiscal year, FHA has been executing an overall asset management strategy aimed at ramping up REO alternatives. FHA is expanding a pilot in which properties secured by non-performing FHA-insured loans are offered for sale by the lender who has completed the foreclosure process and sold to third party purchasers without ever being conveyed to FHA. This method of disposing of these properties is expected to yield lower losses for the MMI Fund than selling them through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing an REO property are eliminated.

The Distressed Asset Stabilization Program, another REO alternative that improves Fund performance, has successfully scaled up operations and is now selling approximately 10,000 loans per quarter. FHA is able to dispose of the non-performing loans, while recouping as much or more than would be recovered from REO disposition and contributing to community stabilization initiatives in cities hit hardest by the recession.

Beginning in 2013, FHA plans to launch a large-scale proactive marketing campaign to promote modification and short-sale strategies for delinquent borrowers. This effort is expected to increase utilization of these programs, which will permit more borrowers to become aware of and take advantage of these opportunities, while reducing foreclosures and decreasing associated losses for FHA.

Again, in combination with improved market conditions, our efforts are producing better results. Loss severity across PFS and REO are down from their historic highs of 48 and 72 percent, respectively, in 2011, to 45 and 61 percent today.

And while we have taken aggressive steps to reduce losses on legacy loans, we have also taken measures to ensure that future books are appropriately priced, so that if there is a default, FHA will have sufficient reserves on hand. These policies include raising mortgage insurance premiums five times since 2009 and reversing a policy that cancelled mortgage insurance premium (MIP) collections when the principal balance of an FHA-backed mortgage reached 78 percent of the original home value.

Improvements in Early Loan Performance

Our most recent monthly and quarterly data shows the combined results of the housing market recovery and FHA's efforts. The 60-day Early Payment Default (EPDs) rate continues to trend down – to .25 percent – the lowest it has been since 2007. Compared to 2012, EPDs have fallen 9 basis points, demonstrating that the credit policy changes made since 2009 are improving the quality of loans endorsed by FHA.

FHA has also made significant changes to credit policy, including establishing a minimum credit score, as well as a two tiered down payment/credit score requirement wherein borrowers with scores less than 580 are required to have a larger downpayment. In addition, we now require manual underwriting for borrowers with credit scores below 620 and debt to income (DTI) ratios over 43 percent, have enhanced

FHA's TOTAL Scorecard, and have increased both downpayments and premiums for borrowers seeking loans in excess of $625,500.

These steps, as seen through the reduction in EPDs, ensure that home buyers using FHA-insured financing are capable of meeting their mortgage obligations and will not put undue stress on the Fund.

Simultaneously, our portfolio growth continues to slow, resulting in a declining market share, encouraging the return of private sources of mortgage capital to the market.

In fact, the number of FHA single family loan endorsements by loan count, has declined to levels comparable to those seen in fiscal years 2002 and 2003, when FHA's market share was lower than it is today, indicating that FHA's current market share is primarily due to a substantial decrease in the size of the total mortgage market rather than exceptionally high FHA loan volumes. As the market continues to recover, FHA's role will naturally recede further.

Tools for Management of the Fund and Additional Considerations

Tools for FHA

The FHA Solvency Act of 2013 provides many tools and changes that FHA has requested to better manage the Fund – and we thank the Committee for its commitment to their inclusion. FHA has long believed them to be necessary in order to create a more responsive business model, better able to react to stress in the market. The Committee's support for these tools will provide flexibility, resources, and enforcement mechanisms that will result in a stronger, more secure MMI Fund.

- Indemnification Authority for Direct Endorsement Lenders will allow FHA to seek indemnification from these lenders, which account for 70 percent of all FHA approved lenders. With this authority, FHA will be able to obtain indemnification from all its approved lenders for loans that fail to comply with its guidelines.

- The revised compare ratio will allow comparison on origination and underwriting criteria, defaults and claims, as well as some other factors the Secretary determines increase risk to the MMI Fund – enabling FHA to respond appropriately to changes in the market and mitigate risk.

- The authority to structurally change the Home Equity Conversion Mortgage (HECM) program through Mortgagee Letters will allow FHA to make critical changes quickly, preserving this program, which is a vehicle that allows seniors to age in place. These changes will help FHA ensure that new HECM originations, now limited to three product lines, meet the needs of the target population, reduce risks to the MMI Fund and avoid dramatic actions that would harm the very consumers these loans are intended to help in order to ensure actuarial soundness. Given the high pace of change within the reverse mortgage market and its impact on the MMIF, it is vital that FHA be able to make program improvements quickly.

Points for Further Discussion

While the bill offers a measured approach that provides tools to manage the MMI Fund, there are some topics which warrant further discussion and clarification to more directly address our shared concerns.

- *HECM:* We thank the committee for including the language in Section 13 which will allow FHA to make structural changes to the HECM product through Mortgagee Letter which will stabilize both the product and the Fund. During this work period, we urge the Senate to take up H.R.

2167 – which has passed the House and accomplishes the same goals of this section – and the bill introduced earlier this year by Senator Menendez.

- *Servicing as a Recovery Tool:* As currently drafted, Section 4 does not give FHA the tools necessary to ensure servicers are being held accountable for their performance and to allow FHA to shift servicing to a specialized sub-servicer if they cannot fulfill their obligations under the contract of insurance. This additional authority would minimize losses to the Fund by facilitating more effective loss mitigation, yielding better results for both borrowers and FHA.

- *Capital Restoration:* Section 7 establishes mandatory premium increases during times when the capital reserve ratio falls below required levels. While we share the Committee's desire to ensure that future FHA leadership takes the appropriate steps to protect the Fund and satisfy the capital reserve ratio, as we have shown since 2009, premiums are only one factor to consider in rebuilding that supplemental account.

  As written, the language does not account for the impact increased premiums themselves will have on access to credit, endorsement values, and ultimately the health of the Fund – potentially undermining the goal of increasing the capital reserve. Especially when it is necessary to respond quickly during times of economic uncertainty or stress, this approach will have unintended consequences for the Fund. Therefore, we ask the Committee to continue to work with us in crafting language that best facilitates recapitalization using the full range of options available.

Additional Considerations

Despite many policy and organizational changes proposed in this bill there are a number of statutory constraints which FHA strongly feels limit our ability to manage risk appropriately and are having a negative impact on FHA's fiscal health. These constraints include an increasingly complex mortgage market, aging FHA systems and infrastructure, a need for additional skills and expertise, and difficulty responding quickly to major risk issues as a result of contractual and statutory limitations. For FHA to manage risk and maintain operations as 21st century mortgage insurer, these constraints must be dealt with appropriately. For that reason, we would like to continue to explore with the Committee tools which can be leveraged to allow FHA to minimize risk to the Fund and taxpayers while continuing to serve consumers.

Conclusion

Chairman Johnson, Ranking Member Crapo, I would again like to thank the Committee, under your joint leadership, for taking up the issue of long-term solvency of the FHA MMI Fund. The economic and housing crisis and recovery, as well as the new, multidimensional challenges facing our urban, suburban, and rural communities require an FHA that is more agile and responsive to real-time market dynamics. As such, we remain committed to continuously improving our stewardship of FHA. HUD stands at the forefront of the Federal response to the national mortgage crisis, economic recovery, Hurricane Sandy recovery, and the structural gap between household incomes and national housing prices – roles that require an agency that is sophisticated and market-savvy, with the capacity and expertise necessary to galvanize and direct a vast network of partners. Your efforts to ensure that is possible are both timely and necessary, and offer a strong start. I look forward to working with this Committee to continue to strengthen and preserve FHA for future generations.