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Thank you Chairman Allard and Ranking Member Reed for inviting me to be here today to testify on the Administration's proposed FHA Modernization Act.

As you are all aware, the Federal Housing Administration was created in 1934 to serve as an innovator in the mortgage market, to meet the needs of citizens otherwise underserved by the private sector, to stabilize local and regional housing markets, and to support the national economy. This mission is still very relevant, perhaps now more so than ever.

Moreover, the FHA model represents the very best of what government can and should do. Since its inception, FHA has helped more than 34 million Americans become homeowners. By operating through a private distribution network, FHA efficiently reaches families in need of safe and affordable home financing. Simply put, FHA insurance protects lenders against loss, enabling these private sector partners to offer market-rate mortgages to homebuyers who would otherwise remain unserved or underserved. FHA provides a substantial benefit to families, communities, and the entire national economy.

We believe that FHA should continue to play a key role in the national mortgage market and I'm here today to make the case for changes to the National Housing Act that will permit us to continue to fulfill our critical mission.

Let me explain. In recent years, FHA's outdated statutory authority has left the agency out of synch with the rest of the lending industry. Over the last decade, the mortgage industry transformed itself, offering innovative new products, risk-based pricing, and faster processing with automated systems. Meanwhile, FHA continued to offer the same types of products with the same kinds of pricing, becoming less attractive to lenders and borrowers alike.

As a result, FHA's business has dropped precipitously in housing markets all across the nation. For example, in Chairman Allard's home state of Colorado, FHA's volume has dropped from 42,609 loans in 1999 to 18,543 loans in 2005. For Ranking Member Sarbanes, during that same time period, FHA's volume in Maryland dropped from 61,201 to 11,824 loans. And for Ranking Member Reed, FHA's volume in Rhode Island is down from 4,695 loans in 1999 to just 906 loans in 2005.

FHA has fallen behind for a variety of reasons, from outdated business practices to cumbersome program requirements. Over the last nine months, we have made significant changes, streamlining and realigning FHA's operating procedures. While these changes are good and long overdue, they are not enough, a point that FHA's industry partners have clearly conveyed. Therefore, FHA is now requesting that we amend the law to give FHA the flexibility it needs to fulfill its original mission in today's marketplace.

As the dynamic mortgage market passed FHA by, many homebuyers – first-time homebuyers, minority homebuyers and homebuyers with less-than-perfect credit – were left with fewer safe and affordable options. Many of them became homebuyers, but paid a steep price to do so, especially those living in higher cost states, such as California, New York, Rhode Island, and Massachusetts, to name a few.

Without a viable FHA alternative, many homebuyers turned to high-cost financing and nontraditional loan products to afford their first homes. While low initial monthly payments seemed like a good thing, the reset rates on some interest-only loans are substantial and many families are unable to keep pace when the payments increase. In addition, prepayment penalties make refinancing cost-prohibitive. According to Moody's Economy.com, more than $2 trillion of U.S. mortgage debt, or about a quarter of all mortgage loans outstanding, comes up for interest rate resets in 2006 and 2007. While some borrowers will make the higher payments, many will struggle. Some will be forced to sell or lose their homes to foreclosure. The foreclosure rate for subprime loans is twice that of prime loans. And I think we can all agree that foreclosures are bad for families, bad for neighborhoods, and bad for the economy as a whole.

That said, the FHA Modernization Act is part of the solution. FHA reform is designed to give homebuyers who can't qualify for prime financing a choice again.

Moreover, the FHA bill proposes changes that will strengthen FHA's financial position, improving FHA's ability to mitigate and compensate for risk. The proposed changes would permit FHA to operate like every other insurance company in the nation, pricing its products commensurate with the risk, as opposed to having some clients pay too much and some too little. Imagine if a car insurance company charged all clients the same premium – the 17-year-old teenager and a 40-year-old adult would pay the same rate. Is that fair? With a blended rate, those who know they're paying too much find themselves another insurance company. That leads to a portfolio that is increasingly lopsided: too many riskier borrowers, too few safer borrowers, and an insurance fund that poses a risk of default. This type of adverse selection is exactly what happened to FHA over the last decade. Those who were lower credit risks went elsewhere. The premium changes proposed in the bill will restore balance to the FHA funds, providing appropriate levels of revenue to operate in a more fiscally sound manner.

I know my introduction was lengthy, but I want you to understand how important FHA reform really is – for FHA, for the homebuyers we serve, and for the industry as a whole. FHA's private sector partners – the brokers, the realtors, the lenders, the home builders – want to tell their clients about the FHA alternative. They want low- to moderate-income homebuyers to have a safer, more affordable financing option. They want FHA to be a viable player again.

Now let me explain a little bit about the simple changes we're proposing. For one, we're proposing to eliminate FHA's complicated downpayment calculation and three percent cash investment requirement. Before the rest of the market began offering low downpayment loans, FHA was often the best option for first-time homebuyers because it required only a minimal downpayment. But, as I said before, the market passed FHA by. Last year, 43 percent of first-time homebuyers purchased their homes with *no* downpayment. Of those who did put money down, the majority put down two percent or less.

The downpayment is the biggest barrier to homeownership in this country, but FHA has no way to address the barrier without changes to its statute. The FHA Modernization Act proposes to permit borrowers to choose how much to invest, from no money down to one or two or even ten percent.

The bill also proposes to provide FHA the flexibility to set the FHA insurance premiums commensurate with the risk of the loans. For example, no downpayment loans would be priced slightly higher, yet appropriately, to give homebuyers a fairly-priced option and to ensure that FHA's insurance fund is compensated for taking on the additional risk. FHA would also consider the borrower's credit profile when setting the insurance premium. FHA would charge lower-credit risk borrowers a lower insurance premium than it does today, and higher-credit risk borrowers would be charged a slightly higher premium. In so doing, FHA could reach deeper into the pool of prospective borrowers, while protecting the financial soundness of the FHA Fund.

A slightly higher premium would increase a borrower's monthly payment only minimally. For example, on a $200,000 loan, a 1 percent upfront premium financed into the loan would cost the borrower $12.64 per month; a 2 percent premium would cost $25.28 and a 3 percent premium, $37.92. Clearly, this higher premium is still affordable. Moreover, it's a smart investment, because the borrower is paying for the FHA insurance to obtain a market rate loan.

The primary concerns with a risk-based pricing approach are that FHA will target people who shouldn't be homebuyers and charge them more than they should pay. I want to address these concerns directly. Our goal is to reach families who are capable of becoming homeowners and to offer them a safe and fairly-priced loan option.

With a risk-based premium structure, FHA can reach hard-working, credit-worthy borrowers – such as store clerks, bus drivers, librarians, and social workers – who, for a variety of reasons, do not qualify for prime financing. Some have poor credit scores due to circumstances beyond their control, but have put their lives back together and need a second chance. For some, the rapid appreciation in housing prices has simply outpaced their incomes. Many renters find it difficult to save for a downpayment, but have adequate incomes to make monthly mortgage payments and do not pose a significant credit risk. They simply need an affordable financing vehicle to get them in the door. FHA can and should be there for these families.

The higher premiums that FHA will charge some types of borrowers are still substantially lower than they would pay for subprime financing. Let me repeat that point: the higher premiums that FHA will charge some types of borrowers are still substantially lower than they would pay for subprime financing. The cost of a loan with a higher FHA insurance premium is still substantially lower than the cost of a loan with a higher interest rate. For example, if FHA charged a 3 percent upfront insurance premium for a $200,000 loan to a credit-impaired borrower versus that same borrower obtaining a subprime loan with an interest rate 3 percent above par, the borrower would pay over $255 more in monthly mortgage payments with the subprime loan and over $125,000 more over the life of the loan, if they kept it for a full 30-year term.

Moreover, as I stated earlier, FHA intends to lower the insurance premium for many borrowers. FHA will charge lower-risk borrowers a substantially lower premium than these types of borrowers pay today. For example, homebuyers with higher credit scores who choose to invest at least 3 percent in a downpayment may pay as little as half a percent upfront premium.

So, while FHA may charge riskier borrowers more (and less risky borrowers less) than it does today, the benefit is three-fold. First, FHA will be able to reach additional borrowers the agency can't serve today. There is nothing that upsets us more than to see people taken to the cleaners when they would have fared better with an FHA-insured product. Second, these borrowers will pay less with FHA than with a subprime loan. And finally, the FHA Fund will be managed in a financially sound manner, with adequate premium income to cover any losses.

Another change proposed in the FHA Modernization Act is to increase FHA's loan limits. Members of Congress from high-cost states have repeatedly asked FHA to do something about our antiquated loan limits. This bill finally answers their concerns. FHA's loan limit in high-cost areas would rise from 87 to 100 percent of the GSE conforming loan limit and in lower-cost areas from 48 to 65 percent of the conforming loan limit. In between high and lower-cost areas, FHA's loan limit will increase from 95 to 100 percent of the local median home price. This change is extremely important and crucial in today's housing market. In many areas of the country, the existing FHA limits are lower than the cost of new construction. Buyers of new homes can't choose FHA financing in these markets. In other areas, FHA has simply been priced out of the market. For example, in 1999, FHA insured 127,000 loans in the state of California; in 2005, FHA insured only 5,000.

FHA is also proposing some changes to specific FHA products. For example, the bill proposes to permit FHA to insure mortgages on condominiums under its standard single family product. The existing condo program is very specialized and burdensome, as a result of outdated statutory provisions that were written at a time when condominiums were an unfamiliar form of ownership. Condos represent 25 percent of the new and 12 percent of the existing home market today and serve as one of the primary forms of affordable housing for first-time homebuyers. In fact, condos tend to be closer to city centers and offer lower income borrowers an opportunity to buy an affordable home without moving far from their jobs and away from the public transportation that gets them to those jobs. Therefore, FHA should be able to serve condo buyers, just like any other homebuyers, under its standard single family program.

Our reform bill also proposes to modernize the Title I manufactured housing program, eliminating the portfolio insurance feature from the program and increasing the loan limits to reflect the real cost of manufactured housing today. The existing statute restricts FHA claim payments to 10 percent of the value of a lender's loan portfolio. 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. Ginnie Mae has testified that with the elimination of this outdated insurance model it would reconsider participation in the Title I securities market, which will bring in more lenders and drive down the costs of manufactured home financing.

Finally, the FHA Modernization Act offers some changes to the Home Equity Conversion Mortgage (HECM) program, which enables senior homeowners, aged 62 years or older, to tap into their home equity to live comfortably in their golden years. The bill proposes elimination of the cap on the number of loans FHA can insure; a single, national loan limit set at conforming; and a new HECM for Home Purchase product to permit seniors to move from the family home to more suitable senior housing and convert the purchase loan into a HECM in a single transaction. Today, seniors who want to move, but need additional cash flow to pay their living expenses, must purchase a new home and take out a HECM in two distinct transactions, resulting in two sets of loan fees and charges.

Let me repeat a point I made earlier in the testimony. I want to assure you that the changes we are proposing will not increase the overall risk of the MMI Fund or impose a potential cost on taxpayers. We are proposing to manage the Fund in a financially prudent way, beginning with the change in FHA pricing to match premiums with risk. This will avoid FHA being exposed to excessive risk, as it is today, because some borrowers who use FHA are under-charged for their risk to the Fund while others are overcharged. Of course, we will continue to monitor the performance of our borrowers very closely, and make adjustments to underwriting policies and/or premiums as needed.

I know I've talked a lot here today, but I want to convey to you how passionate I am about the proposed changes. I believe we have an opportunity to make a difference in the lives of millions of low- and moderate-income Americans. We have a chance to bring FHA back into business, to restore the FHA product to its traditional market position. To all those families who can buy a home with prime conventional financing, I say, "Go for it!" They're fortunate and they should take full advantage of that benefit. But for those who can't, FHA needs to be a viable option. And when people ask me why are we proposing these changes, I tell them these exact words: "Families need a safe deal, at a fair price. Families need a way to take part in the American Dream without putting themselves at risk. Families need FHA."

I want to thank you again for providing me the opportunity to testify here today on the FHA Modernization Act. I look forward to working with all of you to make these reforms a reality.