

## **STATEMENT OF BRIAN D. MONTGOMERY**

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Committee on Appropriations  
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“The Federal Housing Administration’s Role in Addressing the  
Housing Crisis”

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Thank you, Chairwoman Murray. I would like to thank you and Ranking Member Bond for inviting me to testify.

As Commissioner of the Federal Housing Administration (FHA), you have asked me to comment on the role my agency is playing in the current housing crisis. I will explain this by discussing the following: our efforts to help homeowners under *FHASecure*, our recent administrative actions that extend FHA assistance to even more homeowners, the prompt need for FHA Modernization, and the proper way to provide downpayment assistance. By covering each of these topics, Madam Chairwoman, I believe you will see that FHA has taken action to help responsible homeowners stay in their homes.

### ***FHASecure***

FHA has been able to use our administrative authority to help hundreds of thousands of Americans refinance their home loans. In August 2007, the President, Secretary Paulson, and Secretary Jackson introduced an effort, *FHASecure*, to help more Americans facing foreclosure refinance into a safer, more secure FHA loan. Since then, more than 150,000 families have been able to refinance with FHA. By year's end, we expect FHA will be able to help a total of about 500,000 families refinance into affordable FHA-insured mortgages.

It is important that the American people know about FHA opportunities. That is why FHA has mailed letters to hundreds of thousands of at-risk homeowners to urge them to refinance with safer, more affordable FHA-backed mortgages. These letters are being sent to homeowners who already have or soon will confront the first reset of their adjustable rate mortgage, and are currently living in locations subject to FHA loan limits. We will be sending these letters out to about 850,000 at-risk homeowners. Our response rate to the call centers has been so high that we need to add staff to accommodate the demand.

### **Additional Actions**

We believe there is more that we can do with *FHASecure*. The reach of this program can and should be extended in a responsible way. Any expansion of *FHASecure* should continue its temporary nature and be focused on helping homeowners who are financially able and responsible, but who cannot refinance and stay in their homes without FHA assistance.

Expansion of *FHASecure* also would need to be achieved in a way that is consistent with the Administration's principles on FHA Modernization. An expansion of *FHASecure* should include special underwriting flexibility to help more families qualify for FHA-insured mortgages. This includes making eligible more borrowers who were late on a couple of mortgage payments. These underwriting changes could also be made in exchange for lenders voluntarily writing down some of the outstanding mortgage principal if necessary to attain a prescribed loan-to-value ratio, and/or balanced with insurance premium adjustments when necessary to protect both the FHA insurance fund and the taxpayer.

FHA operates as a negative credit subsidy program, which means that it does not require Federal appropriations for its credit subsidy cost. Rather, the FHA program is funded through insurance premiums that homeowners pay themselves. In order to keep FHA operating without taxpayer subsidies, the expansions I outlined would be implemented with a new structure under which premiums would be set according to the relative risk borrowers pose. Basing mortgage insurance premiums on the individual risk of each loan, where risk is judged using traditional underwriting standards, is the best way to ensure that the taxpayer is protected and that FHA can help more families stay in their homes. It is how every responsible insurance company operates.

I believe these actions are consistent with our shared view that a robust FHA is needed to address the housing situation. However, it is essential that Congress not legislate specific underwriting criteria that would unnecessarily limit FHA's flexibility.

Certain bedrock principles also need to be maintained. For example, we require that an eligible family live in the FHA-insured home and have documented, verifiable income. That is something that FHA has always done, but in the era of no-doc loans, was a bit of an anomaly. As you know, Madam Chair, many of the problems in the housing market have occurred as a result of lax underwriting standards, and FHA should not be forced legislatively to compromise its fundamental criteria at the future expense of the taxpayer.

With all of this in mind, yesterday HUD announced some further administrative steps that will extend FHA opportunities to more homeowners. These efforts, using current regulatory authority, have extended FHA to the limit of what it can safely and prudently do under its authorizing legislation.

Let me be more specific. Yesterday, at a hearing before the House Financial Services Committee, I announced a plan to help break the cycle of foreclosures. This new plan is targeted to distressed homeowners struggling to make their current mortgage payments and have no place to turn to refinance their loans as their homes lose value.

By tapping into its existing authority, *FHASecure* will now serve borrowers in subprime ARMs who have gone in to default as the result of some extenuating financial circumstance that has temporarily hindered their ability to afford their existing mortgage payments. These borrowers would still have sufficient income to make payments on the new FHA mortgage, but are stretched or unable to meet the terms of their existing mortgage. The refinance will put them in a sounder financial position. Borrowers who meet FHA's other underwriting criteria but have missed two monthly mortgage payments, either consecutively or at two different times over the previous twelve months, will qualify for a standard 97 LTV loan. For borrowers who cannot meet these standards, FHA will permit up to three months of delinquency, again, which could be a consecutive 90-day late period or three 30-day late periods. But, FHA will limit the LTV ratio for these borrowers to 90 percent. The 10 percent equity cushion, along with the required premiums, will protect taxpayers against unnecessary risk.

Last August, *FHASecure* was targeted to help creditworthy homeowners who faced a rate reset. We have now helped over 150,000 homeowners refinance into a safer option. Now, expanding *FHASecure* to additional borrowers will offer lenders a refinancing alternative that makes voluntarily write-downs a viable option.

Madam Chairwoman, reducing the principal amount owed on subprime mortgages helps both troubled borrowers and lenders. Borrowers would reduce their principal payments and get to keep their homes. Lenders avoid taking a more significant loss at foreclosure. Neighbors avoid vacant homes in their neighborhood, depressing their home values. And localities keep a viable tax base to fund community health, schools, and other valuable services.

FHA underwriting standards will minimize the risk of helping more families use *FHASecure* to keep their homes. Let me emphasize that last point. FHA will ensure borrowers have the capacity to repay their mortgages, regardless of their current credit score or potential delinquency on their existing mortgage, and will ensure the borrower did not make misrepresentations on their application. Borrowers must also show a reasonable credit history, show employment history, and have some personal equity in the deal, and fully document and verify their income. Borrowers will be required to pay upfront and annual premiums on their loans, which directly contribute to the soundness of FHA's insurance fund and protect taxpayers. Since more than 90 percent of FHA-backed loans are 30-year fixed rate mortgages, this gives us predictable, stable income.

I want to also stress this: all the changes to *FHASecure* we have implemented or about to implement will help us reach about 500,000 homeowners in total by the end of this year.

Of course, the President's stimulus package is also making a difference. By temporarily increasing FHA loan limits, we can back more mortgages in high-cost states and help homeowners hold on to their houses. The new loan limits were announced last month, and I have spoken with many people in the housing industry who believe that this action will quickly assist many.

### **FHA Modernization**

For the last two years, the Administration has suggested ways to improve the agency's ability to fulfill its mission to help low-income and first-time homebuyers who are not served by the conventional mortgage market. I believe FHA should remain true to its mission. FHA Modernization is one constructive step, a step I know you have strongly supported. And I want to thank the subcommittee for that bipartisan support. The Administration continues to urge Congress to reach agreement on a bill to modernize FHA that the President can sign it into law.

However, there are two key components that must be part of any final FHA Modernization bill.

First, we must maintain FHA's ability to offer a fair and equitable mortgage insurance premium structure that is commensurate with the risk presented by the loans it insures.

Any bill must give FHA the tools needed to price for additional risk. Unfortunately, neither the House (H.R. 1852) nor Senate (S. 2338) provisions succeed in accomplishing this. Instead, the Senate bill would impose a 12-month moratorium on HUD's proposed modification to the current FHA premium structure. To ensure the solvency and continued operation of FHA's single family mortgage insurance fund, flexible risk-based premiums are necessary both now and in the future.

Over the next several months FHA plans to implement a risk based premium structure administratively, up to our 2.25% cap. We hope that Congress will modify the bills to support this effort to permit FHA to continue to be a self sustaining government agency. As you know, few government programs can claim the same. We do not want to cross that line, particularly at a time when we are most needed, and as I have testified to other Committees, reforms or changes to the program are already needed to avoid crossing the line in October at the start of FY 2009.

Second, legislation must include a provision, like that in S. 2338, to expressly prohibit down-payment assistance from the seller or any other person or entity that stands to benefit from the transaction financially. Insured loans relying upon seller-funded down payment assistance have been demonstrated to have an unacceptably higher risk of default and foreclosure – harming borrowers they intend to help and risking the integrity of the entire FHA program and its ability to help more at-risk low- and moderate-income homeowners. Data clearly demonstrates that FHA loans made to borrowers relying on seller-funded downpayment assistance go to foreclosure at three times the rate of loans made to borrowers who make their own downpayments. We simply cannot sustain this business. We want FHA to be here not just for this generation, but for generations to come.

FHA Modernization has bipartisan support. It is the appropriate next step to address the housing downturn. Congress needs to make this important bill an immediate priority over other housing proposals that are under consideration. As a first order of business, a good FHA Modernization bill must be sent to the President. We need FHA modernization as soon as possible. Every day of delay places qualifying homeowners at unnecessary risk.

### **Downpayment Assistance**

That is why it is extremely important to make the right choice on downpayment assistance. I know there is legislation under consideration that would ban seller-funded downpayment assistance. Yes, it should be banned. That would be a good thing to do.

As you know, in September, FHA proposed a rule to clear up this situation. Because of court action, the rule has not been implemented. But I believe our approach is sound. The FHA rule proposed in September preserves HUD's long-standing policy of permitting FHA-insured borrowers to rely on downpayment assistance from family members, employers, governmental entities, or charitable organizations. It also preserves HUD's long-standing policy of permitting sellers to contribute up to 6 percent of the sales price toward the buyer's actual closing costs, prepaid expenses, discount points and other

financing concessions, such as temporary interest rate buydowns. It clarifies that the downpayment funds cannot be derived from sellers - directly or indirectly - or any other party that stands to benefit financially from the purchase transaction. Of course, nonprofits can still play a role in providing downpayment assistance in the form of a gift as long, so long as they do not collect “donations” from sellers, who have a financial stake in the sales transactions.

The Administration does not support *seller-funded* downpayment assistance. That practice is nothing but a financial shell game where the seller wins and the homebuyer often loses. The FHA rule on downpayments helps to maintain the integrity of our process and is crucial to the work of FHA. Our rule puts an end to a type of self-serving, circular-financing arrangement. It avoids the harmful effects on homeowners and the housing market.

By closing this loophole, FHA will help prevent more people from being steered into a situation where they do not understand the fine print and end up being foreclosed upon. Closing this loophole also helps ensure the financial health of the fund. FHA operates as a negative credit subsidy program, which means that it does not require Federal appropriations for its credit subsidy cost. Rather, the FHA program is funded through insurance premiums that homeowners pay themselves. However, the continuation of seller-financed downpayment assistance loans insured by FHA threatens to force the fund into a positive credit subsidy for fiscal year 2009. We must ensure that the financial solvency of the Fund is not compromised. I really want to stress this last point...*the financial solvency of the fund must not be compromised.*

In other words, the Administration would welcome a legislative ban on the practice of seller-funded downpayment assistance. That would be a prudent action. And I am hopeful that the court injunction against the FHA proposed rule will be lifted, allowing us to put in place the regulatory action that will protect homebuyers and preserve the integrity of the FHA process.

### **Conclusion**

Madam Chairwoman, in conclusion, promoting homeownership remains one of the central goals of this Administration, and I know it is a goal you share. We are proud of the fact that millions of new homeowners were created since the start of the decade.

We believe FHA has a role to play, provided it remains within our mission and we maintain its fiscal integrity so that it is here for future generations.

Thank you again for inviting me to testify today.

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