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TRANSPORTATION AND HOUSING AND URBAN DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 2013

THURSDAY, MARCH 8, 2012

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:06 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Patty Murray (chairman) presiding.

Present: Senators Murray and Collins.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FEDERAL HOUSING ADMINISTRATION

STATEMENT OF HON. CAROL GALANTE, ACTING FEDERAL HOUSING ADMINISTRATION COMMISSIONER AND ASSISTANT SECRETARY FOR HOUSING, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OPENING STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. Good morning, and welcome to Acting Federal Housing Administration (FHA) Commissioner Carol Galante. We appreciate your coming today and your testimony. You have assumed this role at a very pivotal time for both the market and FHA. And we really want to thank you for your service and coming today.

Back in early 2007, this subcommittee held a hearing on FHA that raised questions about its role and relevance as its market share had fallen to around 3 percent. At that time, home prices were on a seemingly unstoppable climb, and based on the belief that home prices would continue to rise, credit was flowing freely.

Millions of Americans became homeowners, many through exotic mortgage products that required very little documentation, and included attractive offers like interest-only payments and no down payments. FHA's traditional 30-year fixed mortgage, which required documentation and underwriting, simply could not compete.

But the promises made to homeowners and investors alike were too good to be true. When the risks associated with these mortgages began to materialize, it was far too late. And when defaults and foreclosures skyrocketed, the impact was felt not only by defaulting homeowners, but by entire communities that watched their home values plummet, investors who bet on these products and lost, and older Americans who saw their pensions disappear.

FHA quickly stepped in after the crash to ensure a functioning mortgage market, the primary function for which it was designed during the Great Depression. There is no question that stepping into the faltering housing market exposed FHA to greater risk, but it took on this risk in order to support the broader housing market, and without its support, the cost of the market and to taxpayers today would likely be far higher.

So, today we are not asking about FHA's role and relevance. FHA now supports nearly 30 percent of the purchase market, and almost 16 percent of all loans, including refinances. And its value has been made clear over the past few years. Instead we are now asking how we protect the taxpayer from the risks associated with its increased role in the market, and how and when do we scale back FHA's presence in the market?

FHA's fiscal soundness depends in large part on broader market and economic conditions. As Secretary Donovan testified last week, the biggest factor in the health of FHA's Mutual Mortgage Insurance (MMI) Fund is the direction of home prices. While we are seeing signs that the housing market has hit bottom and is starting its climb back up, risks remain. With over 22 percent of mortgages in the United States underwater, elevated levels of foreclosures, and an extensive shadow inventory of properties, the path of home prices remains uncertain.

I look forward to having this discussion about the potential risks that remain in the market, and what steps can and should be taken to strengthen the market and FHA.

This week, the President announced changes to the FHA's Streamline Refinance Program that will make it easier for existing FHA borrowers to benefit from low interest rates. And in February, the administration released a plan to further aid the market by creating opportunities for homeowners to refinance into more affordable mortgages. It has also pushed for a greater use of principal write-downs.

These proposals offer opportunities to make mortgages more affordable for homeowners, while at the same time putting money back into their pockets, and in some cases, giving them a chance to build equity once again.

These proposals are not written without their own risks and costs. Allowing conventional borrowers to refinance into FHA loans adds risks to FHA, even if not directly to the MMI Fund. Under the administration's proposal, this cost would be covered by a financial crisis responsibility fee paid by banks. In addition to the financial risks, policies such as principal write-downs also raise concerns about moral hazard. In evaluating these proposals, we must have an understanding of what is currently holding the market back from a stronger recovery, and if the long-term benefits of public intervention outweigh the shorter term costs.

The administration is looking at ways also to address the growth in the number of Government-owned properties. FHA along with Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) own about one-quarter of 1 million foreclosed properties. These properties are costly for the Government to manage and contribute to the decline of home prices.

As we look for ways to address the shadow inventory, millions of Americans are unable to find affordable housing. According to a study released by the Department of Housing and Urban Development (HUD) last year, over 7 million Americans pay more than 50 percent of their income on housing, which represents a 20-percent increase in worst case housing needs between 2007 and 2009.

So, I am glad to see FHA, along with the Federal Housing Finance Agency (FHFA), the conservator of Fannie Mae and Freddie Mac, is looking at converting real estate-owned (REO) properties into rental housing. I am interested in hearing from Acting Commissioner Galante on the interest this proposal has garnered, as well as the challenges and benefits that are associated with it.

While much of FHA's fiscal soundness depends on the overall market, there are measures that FHA can take to improve its financial standing. The administration recently announced premium increases to provide additional funding to the MMI Fund. In addition, the budget also includes proposals to increase premiums for its Multifamily and Healthcare Programs. Similar to its single-family business, FHA's presence in these areas has grown in recent years, and these premiums should help strengthen the General and Special Risk Insurance Fund.

Amid the discussions about solvency of the funds and FHA's future in the market, this subcommittee cannot lose sight of FHA's day-to-day operations, so I will be asking critical questions, including: Does FHA have the appropriate staff to manage its portfolio? Does it have the tools it needs to assess and manage risk? And does it have the means and authority to protect taxpayers from fraudulent lenders and excessive losses?

In recent years, this subcommittee has worked to provide FHA with the resources to increase its hiring, support a new risk office, and invest in much needed technology upgrades. In a constrained budget environment, Federal employees and administrative expenses are often the first items to be cut, but in the long term, costs resulting from weak oversight are bound to outweigh any savings that would result from cutting FHA's workforce.

And as we climb back from this housing crash, we must also remember the lessons learned from the rise and the fall of the housing market. We must have soundly underwritten mortgages and a process that is fair and transparent from the moment a potential homeowner applies for a mortgage, all the way through loss mitigation or foreclosure.

This crisis has also taught us the importance of having a balanced national housing policy, one that includes both rental and homeownership opportunities. At the same time, we must be careful not to over correct, as is happening today, and close the door to homeownership for hardworking, responsible Americans.

PREPARED STATEMENT

I believe we should continue to strive for a market in which Americans who work hard, provide for their families, and pay their bills have an opportunity to own a home. And I think FHA will continue to be a part of that vision.

So, I look forward to hearing from Mrs. Galante.

[The statement follows:]

PREPARED STATEMENT OF SENATOR PATTY MURRAY

Good morning, I want to welcome Acting Federal Housing Administration (FHA) Commissioner Carol Galante to the subcommittee today to talk about FHA. Ms. Galante, you have assumed this role at a pivotal time both for the market and FHA and I want to thank you for your service.

FHA'S ROLE IN SUPPORTING THE MARKET

Back in early 2007, this subcommittee held a hearing on FHA that raised questions about its role and relevance, as its market share had fallen to around 3 percent. At that time, home prices were on a seemingly unstoppable climb. And based on the belief that home prices would continue to rise, credit flowed freely.

Millions of Americans became homeowners—many through exotic mortgage products that required little documentation, and included attractive offers like interest-only payments and no down payment. FHA's traditional 30-year fixed mortgage, which required documentation and underwriting, simply could not compete.

But the promises made—to homeowners and investors alike—were too good to be true. When the risks associated with these mortgages began to materialize, it was far too late. And when defaults and foreclosures skyrocketed, the impact was felt not only by defaulting homeowners, but also by entire communities that watched their home values plummet, investors who bet on these products and lost, and older Americans who saw their pensions disappear.

FHA quickly stepped in after the crash to ensure a functioning mortgage market, the primary function for which it was designed during the Great Depression.

There is no question that stepping into the faltering housing market exposed FHA to greater risk. But it took on this risk in order to support the broader housing market, and without its support, the cost to the market and to taxpayers today would likely be far higher.

So, today, we are not asking about FHA's role and relevance. FHA now supports nearly 30 percent of the purchase market and almost 16 percent of all loans, including refinances. And its value has been made clear over the past few years. Instead, we are now asking: How we protect the taxpayer from the risks associated with its increased role in the market, and how and when do we scale back FHA's presence in the market?

FISCAL SOUNDNESS OF FHA'S MUTUAL MORTGAGE INSURANCE FUND

FHA's fiscal soundness depends in large part on broader market and economic conditions. As Secretary Donovan testified to last week, the biggest factor in the health of FHA's Mutual Mortgage Insurance (MMI) Fund is the direction of home prices.

While we are seeing signs that the housing market has hit bottom and is starting its climb back up, risks remain. With over 22 percent of mortgages in the United States underwater, elevated levels of foreclosures, and an extensive shadow inventory of properties, the path of home prices remains uncertain.

I look forward to having a discussion about the potential risks that remain in the market, and what steps can and should be taken to strengthen the market and FHA.

NEW PROPOSALS TO AID THE MARKET

This week, the President announced changes to the FHA Streamline Refinance Program that will make it easier for existing FHA borrowers to benefit from low interest rates.

And in February, the administration released a plan to further aid the market by creating opportunities for homeowners to refinance into more affordable mortgages. It has also pushed for greater use of principal write-downs.

These proposals offer opportunities to make mortgages more affordable for homeowners while, at the same time, putting money back into their pockets and in some cases giving them a chance to build equity once again.

These proposals aren't without their own risks and costs. Allowing conventional borrowers to refinance into FHA loans adds risk to FHA—even if not directly to the MMI Fund. Under the administration's proposal, this cost would be covered by a Financial Crisis Responsibility fee paid by banks.

In addition to the financial risks, policies such as principal write-downs also raise concerns about moral hazard. In evaluating these proposals, we must have an understanding of what is currently holding the market back from a stronger recovery, and if the long-term benefits of public intervention outweigh the short-term costs.

The administration is also looking at ways to address the growth in the number of Government-owned properties. FHA, along with Fannie Mae and Freddie Mac, own about a quarter of a million foreclosed properties. These properties are costly for the Government to manage and contribute to the decline of home prices.

As we look for ways to address the shadow inventory, millions of Americans are unable to find affordable housing. According to a study released by HUD last year, over 7 million Americans pay more than 50 percent of their income on housing, which represents a 20-percent increase in worst case housing needs between 2007 and 2009.

So, I am glad to see that FHA, along with the Federal Housing Finance Agency, the conservator of Fannie Mae and Freddie Mac, is looking at converting real estate-owned (REO) properties into rental housing.

I am interested in hearing from Acting Commissioner Galante on the interest this proposal has garnered, as well as the challenges and benefits associated with it.

SUPPORT FOR FHA OPERATIONS

While much of FHA's fiscal soundness depends on the overall market, there are measures that FHA can take to improve its financial standing.

The administration recently announced premium increases to provide additional funding to the Mutual Mortgage Insurance Fund.

In addition, the budget also includes proposals to increase premiums for its multi-family and healthcare programs.

Similar to its single-family business, FHA's presence in these areas has grown in recent years, and these premiums should help strengthen the General and Special Risk Insurance Fund.

Amid the discussions about solvency of the funds and FHA's future in the market, this committee cannot lose sight of FHA's day-to-day operations. So, I will be asking critical questions, including: Does FHA have the appropriate staff to manage its portfolio? Does it have the tools it needs to assess and manage risk? And does it have the means and authority to protect taxpayers from fraudulent lenders and excessive losses?

In recent years, this committee has worked to provide FHA with the resources to increase its hiring; support a new Risk Office; and invest in much-needed technology upgrades.

In a constrained budget environment, Federal employees and administrative expenses are often the first items to be cut, but in the long term, costs resulting from weak oversight are bound to outweigh any savings that would result from cutting FHA's workforce.

CLOSING

And as we climb back from the housing crash, we must also remember the lessons learned from the rise and fall of the housing market.

We must have soundly underwritten mortgages and a process that is fair and transparent from the moment a potential homeowner applies for a mortgage all the way through loss mitigation or foreclosure.

This crisis has also taught us the importance of having a balanced national housing policy—one that includes both rental and homeownership opportunities.

At the same time, we must be careful not to overcorrect—as is happening today—and close the door to homeownership for hardworking, responsible Americans.

I believe that we should continue to strive for a market in which Americans who work hard, provide for their families, and pay their bills, have an opportunity to own a home.

And I think that FHA will continue to be part of that vision.

I look forward hearing from Ms. Galante and with that I turn it over to Senator Collins.

Senator MURRAY. And with that, I turn it over to Senator Collins for her opening statement.

STATEMENT OF SENATOR SUSAN M. COLLINS

Senator COLLINS. Thank you very much, Madam Chairwoman. And thank you for holding this hearing on FHA and the future of the housing finance market. I join you in welcoming Acting Commissioner Carol Galante before our subcommittee this morning.

I want to begin my remarks by commending the administration's new protections for our Active Duty military servicemembers and veterans based on the recent settlement with the Nation's largest banks. It is appalling to think that lenders were taking advantage of the very people protecting our Nation. While not every lender was culpable, obviously, the fact that any of them were doing this is totally unacceptable.

While the administration has made several announcements regarding existing housing programs, the administration has yet to present a comprehensive plan to stabilize the housing market and to reinvigorate private sector participation.

HUD faces many challenges in balancing the goal of strengthening responsible homeownership while minimizing the financial risk to the FHA and, thus, the taxpayers. Ultimately, FHA should play a more limited role in the mortgage market and help encourage the private sector to reassert its primacy.

Since its inception, FHA has provided mortgage insurance for more than 39 million single-family home mortgages, and 53,000 multifamily mortgages. This program finances nearly 30 percent of home purchase loans and about 10 percent of refinance loans nationwide.

FHA continues to partner with current and prospective homeowners during these difficult economic times. In addition to helping FHA program participants refinance to take advantage of lower interest rates, FHA also assists non-FHA homeowners in refinancing untenable mortgages. When financially sound, FHA is an essential component of the recovery of the housing market.

The weakening of our housing sector over the past several years has had a tremendously negative impact on far too many families and communities throughout the Nation. The housing market recession is not yet over, and a sustained recovery is still uncertain. The Federal Reserve recently reported that on average, national housing prices had fallen 33 percent from their peak in 2006. Underscoring the Federal Reserve's view that housing prices remain under pressure, Standard & Poor's Case-Shiller Index for U.S. home prices is down 4 percent from last year. This is particularly troubling since FHA currently insures over $1 trillion in mortgages.

The agency's role has dramatically expanded since the beginning of the housing crisis. Prior to the crisis, FHA accounted for less than 4 percent of the single-family housing market. HUD now estimates that FHA accounts for nearly 16 percent of the overall market share.

It is also troubling that for the third consecutive year, FHA has not met its statutory requirement of maintaining a 2-percent capital reserve ratio. Further, the budget indicates that FHA could have required as much as $688 million from the Treasury in order to remain solvent. Fortunately, it has, in essence, been bailed out by the recent foreclosure settlement agreement.

PREPARED STATEMENT

These are not easy issues to resolve, but they are critically important to our Nation's long-term economic health, and to the housing needs of many American families. I remain concerned that we must reform our present housing finance programs, but in doing so, we must remain ever mindful to limit the taxpayer's exposure to additional financial losses.

Thank you, Madam Chairman.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SUSAN M. COLLINS

Chairman Murray, thank you for holding this important hearing on the Federal Housing Administration (FHA) and the future of the housing finance market. I join you in welcoming Acting Commissioner Carol Galante before our subcommittee this morning.

I want to start by commending the Administration's new protections for our active military servicemembers and veterans based on the recent settlement with the Nation's largest banks. It is appalling to think that lenders were taking advantage of the very people protecting our Nation.

While the Administration has made several announcements regarding existing housing programs, they have yet to present a comprehensive plan to stabilize the housing market and reinvigorate private sector participation.

The Department of Housing and Urban Development (HUD) faces many challenges in balancing the goal of strengthening responsible homeownership while minimizing the financial risk to FHA and the taxpayer. Ultimately, FHA should play a more limited role in the mortgage market and help encourage the private sector to reassert its primacy.

Since its inception, FHA has provided mortgage insurance for more than 39 million single-family home mortgages and 53,000 multifamily mortgages. The program finances nearly 30 percent of home purchase loans and about 10 percent of refinance loans nationwide.

FHA continues to partner with current and prospective homeowners during these difficult economic times. In addition to helping FHA program participants refinance at lower interest rates, FHA also assists non-FHA homeowners in refinancing untenable mortgages. A financially sound FHA is an essential component in the recovery of the housing market.

The weakening of our housing sector over the past several years has had a tremendous impact on families and communities throughout the Nation. The housing market recession is not yet over, and a sustained recovery is still uncertain. The Federal Reserve recently reported that on average national housing prices have fallen 33 percent from their 2006 peak. Underscoring the Federal Reserve's view that housing prices remain under pressure, Standard & Poor's Case-Shiller index for U.S. home prices is down 4 percent from last year.

This is particularly concerning since FHA currently insures over $1 trillion in mortgages. The agency's role has dramatically expanded since the beginning of the housing crisis. Prior to the crisis, FHA accounted for less than 4 percent of the single family housing market; HUD now estimates that FHA accounts for nearly 16 percent of the overall market share.

It is troubling that for the third consecutive year, FHA has not met its statutory requirement of maintaining a 2-percent capital reserve ratio. Further, the budget indicates FHA could have required as much as $688 million from Treasury in order to remain solvent, had it not been bailed out by the recent foreclosure settlement agreement.

These are not easy issues to resolve, but they are critically important to our Nation's long-term economic health. I remain concerned that we must reform our present housing finance programs. In doing so, we must remain mindful to limit taxpayers' exposure to additional financial losses.

I look forward to working with you on these important issues.

Thank you.

Senator MURRAY. Thank you very much. With that, we will turn to you for your opening statement, and appreciate your being here again today. Thank you.

SUMMARY STATEMENT OF HON. CAROL GALANTE

Ms. GALANTE. Thank you, Chairman Murray and Ranking Member Collins, for the opportunity to testify on the fiscal year 2013 budget request for the Federal Housing Administration. Encompassing HUD's Single Family, Multifamily, and Healthcare Financing Programs, as well as HUD's Housing Counseling Program, our office is critical to ensuring more Americans have the opportunity to realize or maintain the economic security of the middle class.

And the work this administration has done is going a long way to create an economy built to last. Three years ago, with the housing market collapsing and private capital in retreat, we took decisive action to address the crisis and lay the groundwork for recovery.

FEDERAL HOUSING ADMINISTRATION REFORM

Since the start of this administration, FHA has helped nearly 2.8 million families buy a home, and over 1.7 million homeowners refinance into stable, affordable loans. And with your help, we have taken the most significant steps in FHA's history to reduce risk to the taxpayer and reform FHA practices. We have ensured that FHA has the flexibility necessary to price its products appropriately for current risks and market conditions, and we have transformed FHA's risk management system to better align with the needs and realities of the 21st century mortgage market. These reforms have contributed to the most profitable books of business in FHA's 78-year history.

Still, FHA continues to be strained by loans originated before this administration took office. That is why we continue to take action to strengthen FHA's MMI Fund. Our budget reflects the implementation of the 10-basis-point increase to FHA's single-family annual mortgage insurance premiums, as well as an additional 25-basis-point increase to annual premiums for jumbo loans. With these changes, FHA is projected to add $8.1 billion in receipts to the Capital Reserve account in 2013.

In addition, in the past week, FHA has announced two premium changes: An increase in our up-front mortgage insurance premium by 75 basis points, and an adjustment in premiums for Streamline Refinance loans. FHA's Streamline Refinance allows current FHA borrowers who are current on their mortgages to refinance their homes, which at today's low interest rates, can result in $3,000 in annual savings for the typical borrower and bolster their ongoing ability to pay, thereby lowering their risk to FHA.

Those changes to our premiums not included in the budget are expected to produce an additional $1 billion in budget receipts this fiscal year and next, above what is already projected in the President's budget.

We also continue to take significant steps to strengthen accountability for FHA lenders, including the recent servicing and origination settlements with some of the Nation's largest mortgage lenders, which will provide FHA with over $900 million to compensate for losses resulting from their serious violations of FHA requirements by these lenders. And we are seeking expanded authority via legislation that will further enable us to protect the MMI Fund.

While FHA will continue to play an important role in supporting the housing recovery in the year ahead, we are committed to reducing the Government's footprint over time. With FHA's loan volume already down 34 percent from its peak in 2009, and our market share declining to its current level of 15.6 percent, we have set the stage for private capital to return, while ensuring that FHA remains a vital source of financing for underserved borrowers and communities.

While additional risks clearly remain for FHA as the economy continues to recover, the significant reforms and strong enforcement efforts undertaken by this administration are yielding sound and profitable businesses, positioning FHA well for the future.

Despite FHA's important work throughout the crisis, there remain sectors of the housing finance market where additional liquidity is still needed. One of those areas is in small building finance for rental homes. Nearly one-third of the Nation's renters live in small properties of 5 to 49 units, but these properties are at risk of disinvestment because they can be expensive to finance. That is why, as part of the President's budget, HUD is seeking authority to facilitate lending to small multifamily properties through minor changes to our Risk Share Program, and we look forward to working with Congress on this initiative.

HOUSING COUNSELING

Critical to ensuring success of much of FHA's work is housing counseling, and we are making significant improvements to HUD's program. Not only did we get our NOFA (Notice of Funding Availability) on the street within days of the fiscal year 2012 budget passage, but we plan to announce grant awards next week.

And we are also well on our way to setting up a new Office of Housing Counseling. In recognition of the hard work of housing counselors last week, the White House and HUD honored them in a Champion of Change Award. I was honored to participate in this event and meet with people who are tackling this Nation's issues head on.

Finally, as we look to make all of our programs more efficient and effective, the FHA Transformation Initiative will enable us to replace outdated systems with modern technology. These efforts will allow FHA to better assess risk, monitor market trends, and ensure that FHA programs are available for a long time to come.

PREPARED STATEMENT

And so, Madam Chair, this budget reflects this administration's belief that the recovery of our housing market is essential to the restoration of our economy by targeting resources where they are most needed, while ensuring the protection of taxpayer interests. HUD's Office of Housing is doing its part to create housing and communities built to last.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF HON. CAROL GALANTE

Chairman Murray, Ranking Member Collins, and members of the subcommittee, thank you for the opportunity to testify today regarding the fiscal year 2013 budget request for the Federal Housing Administration (FHA).

When this administration took office, the economy was on the brink. Only weeks before this administration took office, the Nation was losing 753,000 jobs a month, our economy had shed jobs for 22 straight months, house prices had declined for 30 straight months, and consumer confidence had fallen to a 40-year low and dramatic steps were taken to prevent a complete financial meltdown. Today, an economy that was shrinking is growing again—and instead of rapid job loss, more than 3.7 million new private sector jobs have been created in the last 23 months, and national unemployment has fallen to a near 3-year low.

And, because the Obama administration moved to keep interest rates low and restore confidence in the housing market more than 13 million homeowners have refinanced their mortgages since April 2009—putting nearly $22 billion a year in real savings into the hands of American families and into our economy. As financing options tightened for millions of Americans due to uncertainties in the credit markets, the Federal Housing Administration played a critical role in returning stability to the housing market by providing access to credit to the millions of families seeking to purchase a home during the worst housing market in generations. This countercyclical role is part of FHA's core mission, and it remains vital as we take further steps to strengthen the housing market.

Today, because we provided a range of solutions to responsible families fighting to hold on to their homes, more than 5.6 million families have been able to reduce their payments and modify their loans to more sustainable terms and foreclosure notices are down nearly 50 percent since early 2009. The resources we provided for communities struggling with concentrated foreclosures have enabled them to fund better uses for almost 100,000 vacant and abandoned properties through our Neighborhood Stabilization Program. Most important of all, because of our commitment to economic growth and recovery, our economy has added private sector jobs for 23 straight months, totaling 3.7 million jobs.

But we know there's still more work to do to ensure that America can create an economy built to last. The fiscal year 2013 budget for the Department of Housing and Urban Development (HUD) tackles these challenges head on. And, as part of HUD's efforts, FHA is continuing its efforts to help responsible families at risk of losing their homes and providing quality affordable rental housing to some of our Nation's most vulnerable families. The President's fiscal year 2013 budget also reflects the reality that we cannot create an economy built to last without taking responsibility for our deficit. The caps set by the Budget Control Act of 2011 promise over $907 billion in total discretionary cuts over the next 10 years, and every department shares a responsibility to make tough cuts so there's room for investments to speed economic growth. Indeed, the overall HUD budget makes tough choices in order to contribute to deficit reduction in a substantial way.

The HUD budget provides $44.8 billion for HUD programs, an increase of $1.4 billion, or 3.2 percent, above fiscal year 2012. This program funding level (i.e., gross budget authority) is offset by $9.4 billion in projected FHA and Ginnie Mae receipts, leaving net budget authority of $35.4 billion, or 7.3 percent below the fiscal year 2012 enacted level of $38.2 billion. Today, I would like to discuss FHA's contributions to the HUD budget and the overall housing market with you in more detail.

RESPONDING TO THE MARKET DISRUPTION

This administration entered office confronting the worst economic crisis since the Great Depression—as mortgages were sold to people who couldn't afford or understand them, while banks packaged them into complex securities that they made huge bets on, leaving American homeowners with the tab. And, while the largest factors contributing to this crisis were market driven, the American people have turned to Congress and the administration for leadership and action in righting our Nation's housing market.

HUD remains firmly committed to working together with communities and individuals to cope with these unprecedented challenges. The Federal Housing Administration and Government National Mortgage Association (GNMA) continue to have a significant impact on the Nation's economic recovery. The activities of the Federal Government are critical to both supporting the housing market in the short term and providing access to homeownership opportunities over the long term, while minimizing the risk to taxpayers. FHA has stepped up to face these unprecedented challenges, playing an important countercyclical role in the housing market today.

Three years ago, as credit markets froze, FHA remained one of the few vehicles available for homeowners to obtain financing through purchase and refinance loans. As a result, FHA's market share grew. This increase in volume reinforced the need for FHA to strengthen credit policy and risk management practices and make lenders accountable. FHA has also taken steps to adjust its premium structure and improve recoveries on its Real Estate Owned (REO) portfolio. These efforts combined are intended to ensure that the Mutual Mortgage Insurance Fund (MMIF) has sufficient resources to account for its growth, while also supporting the housing market. And as a result of these efforts, the books of business originated since this administration took office reflect higher credit quality than FHA historical averages. Yet, we know that there is much work to be done.

While the number of homeowners at risk of losing their home is down significantly, there are still too many families that face hardships and are underwater, and unaffordable monthly payments put them at an increased risk of default, dragging down markets, reducing labor mobility and consumer spending alike. That is why FHA is also taking steps to ease the process whereby FHA borrowers can refinance into new FHA insured loans and take advantage of today's low interest rates, and will work with Congress and other stakeholders to allow non-GSE homeowners who are underwater to refinance into a separate FHA refinance program.

And in areas where the housing crisis has hit the hardest, foreclosures, large volumes of vacant properties, and resultant blight and abandonment, continue to drag down property values and destabilize communities. That is why FHA is working with its Federal partners at Treasury and the Federal Housing Finance Agency to develop programs to convert REO properties to rental properties. By reducing vacancy rates and lowering the overhang of foreclosed properties, this initiative has the potential to stabilize both house prices and neighborhoods, contributing to a more rapid recovery for communities struggling to emerge from the recent recession.

Overall, the efforts of FHA have been integral in providing liquidity in a time of market constriction, keeping people in their homes and addressing the shadow inventory.

OVERVIEW OF THE FHA FISCAL YEAR 2013 BUDGET

FHA has insured over 40 million mortgages through its Single Family, Multifamily and Healthcare programs since its inception in 1934. In exchange for adherence to strict underwriting, application and servicing requirements established by HUD and the payment of mortgage insurance premiums, FHA-approved lenders are able to file a claim with the FHA if a borrower defaults on their mortgage loan.

FHA, directly and through its partners in the housing counseling industry, has played a key role in mitigating the effect of economic downturns in the real estate market. Due to FHA's traditional countercyclical role, the volume of FHA insured loan products increased substantially beginning in 2009 and, while FHA loan volumes have decreased since that peak, the pressures on FHA and its borrowers have also increased due to the economic downturn.

In fiscal year 2013, HUD is requesting $400 billion in loan guarantee authority for the Mutual Mortgage Insurance Fund (MMIF), which will provide an estimated 0.8 million single-family mortgages, and $25 billion in loan guarantee authority for the General and Special Risk Insurance Fund (GI–SRI), which will provide an estimated 156,000 units in multifamily housing properties and an estimated 80,600 beds in healthcare facilities.

The need for this investment is clear as FHA has played a critical role in stabilizing the Nation's mortgage market. At a time when liquidity and access were needed most in the housing market to facilitate the recovery of the broader economy, FHA stepped in to ensure that mortgage capital continued to flow. However, FHA's expanded role is and should be temporary and, to that end, FHA is taking steps in all of its business lines to encourage the return of private capital into the mortgage market while balancing the need to remain a supportive mechanism for all types of housing moving forward.

FHA Multifamily and Healthcare Mortgage Insurance Programs

FHA Multifamily and Healthcare Mortgage Insurance Programs operate under FHA's GI–SRI Fund. These programs encourage critical mortgage financing opportunities that strengthen communities by addressing specialized financing needs including insurance for loans to develop, rehabilitate, and refinance multifamily rental housing, nursing home facilities and hospitals.

FHA has steadily provided liquidity in the market during times of economic constriction. Combined with historically low interest rates, FHA has seen exponential growth in this area. Commitments for FHA insured multifamily housing and healthcare facilities rose from $4.3 billion in fiscal year 2008 to $17.5 billion in 2011. FHA's multifamily and healthcare programs have helped private lenders fill the gap left with the shrinkage of the conventional finance resources. And while this market seems to be rebounding, we continue to expect high levels of mortgage insurance activity for the remainder of fiscal year 2012 and through fiscal year 2013, albeit below the peak in 2011. As of September 2011, the FHA's portfolio of multifamily and healthcare loan guarantees had an unpaid principal balance of $76.4 billion on 12,666 loans and counting.

Given this unprecedented increase in the number and dollar volume of loans insured under GI–SRI, the fiscal year 2013 budget also includes premium increases for FHA's General Insurance and Special Risk Insurance programs that serve market rate multifamily properties and healthcare facilities. These changes, the first premium increase in 10 years for these programs, are intended to ensure that FHA products are priced appropriately to compensate for FHA's risk and encourage the return of private capital to our mortgage markets. The proposed increases range from 5 basis points for 223(a)(7) refinancing to 20 basis points for 221(d)(4) new construction or rehabilitation activity. Premiums for affordable housing projects (such as those with HUD rental subsidies and low-income housing tax credits, as well as those insured under FHA risk-sharing programs) will not be increased.

With the proposed premium increases, FHA Multifamily and Healthcare loans will be priced more appropriately to encourage the return of private capital while, at the same time, continuing to ensure sufficient levels of available capital in these sectors. The increase in premiums also reflect new realities—the Multifamily annual book of business is five times greater than it was just 3 years ago, and the risk profile has changed dramatically. FHA's multifamily apartment portfolio is now more than 50 percent market rate by unit count and 70 percent by unpaid principal balance (UPB), which adds a new component of risk, and a need to take steps to ensure the future viability of the portfolio. With interest rates at a record low the existing portfolio loans could remain in FHA's portfolio longer than the average timeframes and will need to be managed prudently. FHA will publish the proposed increased in the Federal Register in the next 30–60 days and welcomes feedback during the comment period.

During this period of increased activity, FHA has also taken steps to reduce the processing time of loan applications. The Office of Multifamily Housing has centralized processing of Section 223(a)(7) loans to the Office of Affordable Housing Preservation which allows Multifamily Field Office staff to work on the increasingly complex transactions in their pipeline. Additionally, Multifamily Housing and Healthcare have initiated a queue and early warning screening system in order to more efficiently manage workload and provide greater transparency to lenders and borrowers regarding the status of their loan applications. Finally, FHA is conducting monthly performance dialogues with field staff to discuss progress toward meeting processing goals and identify proactive solutions to address performance deficiencies in order to ensure that every effort is taken to reduce processing times and get funds into communities.

This process is already producing results. Survey results demonstrate that staff morale has improved significantly in the offices participating in the pilot roll out of this new process. HUD staff feel encouraged to come up with new and better ways of doing things and these offices are processing applications for multifamily insurance more efficiently and effectively. Offices that had a large backlog of applications have begun to methodically clear out older applications. For instance, our Denver office went from having 30 applications that were older than 90 days in their pipeline to having only 24 overdue applications. In Chicago, 100 percent of the 223(a)(7) loans were processed in less than 30 days and 50 percent of its 223(f) transactions in less than 45 days in January.

In addition, as part of the efforts of FHA's Multifamily and Healthcare programs to strengthen communities by addressing specialized financing needs, HUD is seeking authorization to extend support for Critical Access Hospitals and Small Multifamily Buildings (5–50 units).

We are appreciative of the Congress' longstanding support for Critical Access Hospitals by amending section 242 to permit these important facilities to be eligible for FHA insurance. The most recent amendment to the statute expired on July 31, 2011, and without action to once again to extend the authority under section 242 to allow these hospitals to be eligible, no additional Critical Access Hospitals will be endorsed for FHA insurance. We are grateful to the bipartisan group of Senators that has co-sponsored S. 1431, which would provide this important extension for 5 additional years and we hope that the House (where H.R. 2573 would also extend the critical access authority) and Senate will pass this language this year.

Additionally, as part of the fiscal year 2013 budget, HUD is seeking authority to facilitate lending to small multifamily properties which are an important provider of affordable, but unsubsidized, housing for low- and moderate-income families. According to the 2010 American Community Survey, nearly one-third of renters live in 5- to 50-unit buildings. These buildings also tend to have lower median rents than do larger properties: $400 per month for 5–49 unit properties as compared to $549 per month for properties with 50 of more units. Because they are expensive to finance, particularly in this environment, these properties are at risk of divestment. We look forward to working with Congress to ensure the availability of these unsubsidized, affordable housing units.

The efforts of FHA's Multifamily and Healthcare programs are essential in achieving the Department's mission of strong, sustainable, inclusive communities and quality, affordable housing and services for all Americans.

FHA Single Family Mortgage Insurance Program

The MMIF is the largest fund covering activities of FHA, and is used to pay the claims associated with FHA insured single family mortgage loans. Since 1934, mortgage insurance provided by FHA has made financing available to neighborhoods and geographic areas facing economic uncertainty and to individuals and families not adequately served by the conventional mortgage market. Over 30 percent of all FHA-insured homebuyers are minorities, with 60 percent of all African American and Hispanic homebuyers relying on FHA insured mortgage financing to purchase their homes. In the last year, over half of all African Americans and 45 percent of Hispanics who purchased a home did so with FHA-insured mortgage products. In addition, 75 percent of first-time homebuyers use FHA insured financing.

The fiscal year 2013 budget request will enable FHA to continue its mission of providing access to mortgages for low- and moderate-income families and to play an important countercyclical role in the stabilization and recovery of the Nation's housing market. By facilitating the availability of credit through a variety of FHA-approved lenders, including community banks and credit unions, FHA has helped over 2 million families buy a home since President Obama took office.

Due to reduced liquidity in the conventional mortgage market, FHA saw a surge in activity, reaching a peak in 2009. However, FHA's loan volume has declined 34 percent from its peak in 2009, and its market share is decreasing for the first time since 2006, thereby laying the ground work for private capital to return to the single family market. Today, FHA's total market share is 15.6 percent, down from 17 percent in 2010 and over 21 percent in 2009.

Strengthening FHA Mutual Mortgage Insurance Fund and Paving the Way for Private Capital To Return

While FHA's portfolio has grown in recent years, the fund has also experienced significant losses. The books of business in the few years before 2009 have largely driven the high number of claims to the MMIF. This was driven by overall economic and unemployment trends as well as by the combined effects of, unscrupulous and non-compliant practices on the part of lenders, and a seller-funded downpayment assistance program that allowed many borrowers to obtain mortgages without a meaningful down payment. As a result, the books of business FHA insured prior to the start of this administration have severely impacted the health of FHA's MMIF. But thanks to our efforts since taking office, I can say that the long-term outlook for FHA and the MMIF are now much better than they were in 2009.

The change in trajectory in the performance of FHA-insured loans is no accident. Immediately upon taking office, this administration acted quickly and aggressively to protect FHA's MMI Fund and to ensure its long-term viability. We have taken more steps since January 2009 to eliminate unnecessary credit risk and assure strong premium revenue flows in the future than any administration in FHA history. Indeed, the gains FHA has experiences since 2009 are the result of systematic tightening of risk controls, increased premiums to stabilize near-term finances, and expanded usage of loss mitigation workout assistance to help homeowners avoid foreclosure, stricter lender enforcement, and improved recovery strategies for FHA's REO portfolio.

And, we continue to take steps to further strengthen the fund. In the 2013 budget we announced a 10-bps annual premium increase on all FHA insured loans to comply with the requirement passed by Congress late last year, as well as an additional 25 bps annual premium increase on "jumbo" loans making the total increase for these larger loans 35 bps. And just last week, we announced a 75-bps increase in FHA's upfront mortgage insurance premium that will further increase receipts to FHA by over $1 billion in fiscal years 2012 and 2013, beyond the receipts already included in the President's budget submission, while having minimal impact on consumers.

In addition, we have also taken significant additional steps to increase accountability for FHA lenders. Via a final rule which took effect on February 24, 2012, we clarified the basis upon which FHA will require indemnification from lenders participating in our Lender Insurance program, making clear the rules of the road for lenders and giving FHA a solid foundation for requiring indemnification by lenders for violations of FHA guidelines. And we continue to seek expanded authority via legislation that will further enable us to protect the MMI Fund from unnecessary and inappropriate losses associated with lenders who violate our requirements. Specifically, FHA is pursuing authority to hold our Direct Endorsement (DE) lenders to the same standards as our Lender Insurance (LI) lenders by instituting required lender indemnification for DE lenders who do not following FHA requirements. Current FHA only has this authority for LI lenders. Additionally, FHA is seeking authority to take enforcement actions against all lenders on a broader, geographic basis rather than just at the branch level. This authority would allow FHA to address systematic risk to the MMIF.

Recently, we announced another step to hold lenders accountable for their actions via the settlements with some of America's largest lenders. Through these settlements, FHA will receive over $900 million compensation for losses associated with loans originated outside of FHA requirements, or for which FHA's servicing requirements were violated.

Despite the unprecedented efforts of this administration to alter the trajectory of FHA, considerable risks remain. The FHA MMI Fund has two components: The Financing Account, which holds enough money to accommodate all expected losses on FHA's insured MMI portfolio as of the end of the current fiscal year; and the Capital Reserve Account, which is required to hold an additional amount equal to 2 percent of the insurance in force. Since 2009, the fund's capital reserve ratio has been below that 2-percent level.

The President's budget always includes estimates regarding the status of the Capital Reserve at the end of the current fiscal year. This estimate is based on estimates and projections of future economic conditions, including house prices and other economic factors which may or may not come to pass. The 2013 budget estimate for the FHA Capital Reserve account does not include the almost $1 billion of added revenue over the remainder of fiscal year 2012 and fiscal year 2013 from the additional premium increases announced this week or the proceeds from FHA-approved lenders under the terms of the mortgage settlements. With these additional revenues accounted for, the Capital Reserve is estimated to have sufficient balances to cover all future projected losses, as long as economic conditions do not significantly worsen. Moreover, the budget estimates that FHA will add an additional $8 billion to the MMI Capital Reserve account in 2013, and return to the congressionally mandated capital reserve ratio of 2 percent by 2015.

Office of Housing Counseling

HUD's Housing Counseling Assistance program was developed over 40 years ago at a time of severe divestment in housing, unaffordable interest rates, high unemployment, and irresponsible lending practices. Over time, this program has evolved in depth and complexity, as have the issues that it has had to address. Today, housing counseling is more critical than ever as homeowners seek assistance to navigate the many hurdles associated with obtaining a modification. We know that but for the work of counselors, many homeowners wouldn't have received assistance at all and would likely have lost their home to foreclosure. And it is critical for the many first-time homebuyers looking to secure financing in a market where credit and underwriting standards have dramatically tightened. Housing counseling also assists renters to budget, save, repair their credit, avoid scams, and access unbiased information about housing and financial choices. Last year, HUD housing counseling grants resulted in direct assistance to approximately 186,000 households and leveraged additional non-Federal funding so that HUD-approved housing counseling agencies could educate and counsel nearly 2 million American households last year.

It is tragic that public and private support for housing counseling has been shrinking at a time of great need. We hear anecdotally that housing counseling agencies are laying off skilled, trained housing counselors as traditional sources of funding such as charitable contributions from financial institutions has diminished. Yet recent studies confirm the value of HUD-approved housing counseling. Research evidence documents the role of housing counseling in reducing mortgage delinquency and foreclosure, on helping first-time buyers access and sustain homeownership, and on the special role of counseling related to HECM reverse mortgages. Most studies have found that pre-purchase counseling leads to positive results, reducing delinquency anywhere from 19 to 50 percent, although one study reported no impact.

HUD-approved housing counseling is also effective in the context of mortgage delinquency and default. A nationwide Urban Institute study by Mayer, et al., (2010) of the foreclosure mitigation counseling program (which uses the HUD housing counseling program infrastructure as a base) found that borrowers in foreclosure were 70 percent more likely to get up-to-date on payments if they received the counseling. The same Urban Institute study showed that homeowners who received a mortgage modification to resolve a serious delinquency were 45 percent more likely to sustain that modification if it was obtained with the help of counseling.

Today, HUD approves, monitors, and supports more than 2,600 counseling organizations. Through the new Office of Housing Counseling, HUD will support a network of agencies and counselors, trained and certified to provide tools to current and prospective homeowners and renters so that they can make responsible choices to address their housing needs in light of their financial situation. Further, the Office of Housing Counseling will work to make this network accessible throughout the country to those who need objective and reliable information in order to make sound housing and budget decisions, especially those with low to moderate incomes or otherwise underserved, or those at risk of housing loss or homelessness.

For fiscal year 2013, HUD requests $55 million for the Housing Counseling Assistance Program which is expected to inform over 186,000 households about their housing choices in the areas of purchase or refinancing of their home; rental housing options; reverse mortgages for seniors as part of required Home Equity Conversion Mortgage (HECM) counseling; foreclosure prevention; loss mitigation; preventing evictions and homelessness; and moving from homelessness to a more stable housing situation. These funds will also be used to launch the Office of Housing Counseling which was created as part of the Dodd-Frank Wall Street Reform Act.

The majority of the funds requested in the budget, nearly $45.5 million, are expected to be distributed competitively to support direct provision of a holistic range of services that are appropriate for local market conditions and individual needs. An additional $6 million will be used to strengthen the quality of housing counseling through training grants which will ensure that individual counselors and organizations develop the knowledge and capacity to meet the new certification requirements which HUD must implement under Dodd-Frank. The remaining $3.5 million will be used for administrative contracts and support geared towards streamlining internal HUD processes and enhancing oversight.

Last fiscal year, Congress appropriated $45 million for this program. I am proud to tell you that we expect that the awards for the portion of those funds used for grants will be announced next week, ahead of the aggressive schedule set by the Fiscal year 2012 Appropriations Act. This will ensure that these funds get into the hands of the counseling agencies that need them as quickly as possible.

FHA AS PART OF THE ADMINISTRATION'S EFFORTS TO BOLSTER THE HOUSING MARKET

The increase in FHA's market share is directly tied to its countercyclical role in the recent economic crisis. In addition, FHA is playing a critical role in the administration's work in tackling ongoing foreclosure challenges. Between April 2009 and December 2011, more than 5.6 million mortgage modifications were started—including more than 950,000 permanent HAMP modification saving households an estimated $11 billion in monthly mortgage payments and nearly 1.2 million FHA loss mitigation actions and early delinquency interventions.

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As part of the administration's commitment to help responsible homeowners stay in their homes, we have actively sought to use our current programs and authorities to make homeownership sustainable for millions of American families. Examples of our efforts include:

—*FHA Streamline Refinance.*—An option that allows borrowers with FHA-insured loans who are current on their mortgage to refinance into a new FHA-insured loan at today's low interest rates without requiring additional underwriting, permitting these borrowers to reduce their mortgage payments. This program benefits current FHA borrowers—particularly those whose loan value may exceed the current value of their home—and by lowering a borrower's payment, also reduces risk to FHA. To help more FHA borrowers take advantage of this program, this week FHA announced an adjusted premium structure for these loans, reducing premiums for all Streamline Refinance transactions that are refinancing FHA loans endorsed on or before May 31, 2009, to further incentivize refinance activity. These changes—reducing the upfront mortgage insurance premium for these loans to 1 bp and the annual to 55 bps—will ensure that borrowers benefit from a net reduction in their overall mortgage payment while still ensuring FHA has the resources to pay any necessary claims. This change to the premium structure of Streamline Refinances is also consistent with the annual premium that these borrowers were subject to when their loans were originated.

And, because we see potential for more widespread use of this product, FHA will make changes to the way in which streamline refinance loans are displayed in the Neighborhood Watch Early Warning System (Neighborhood Watch) to reduce lender concern about the potential impact associated with taking responsibility for loans they have not underwritten, making them more willing to offer these loans to borrowers who are current on mortgages already insured by FHA.

—*Short Refinance Option.*—In 2010, FHA made available an option that offers underwater non-FHA borrowers, who are current on their existing mortgage and whose lenders agree to write off at least 10 percent of the unpaid principal balance of the first mortgage, the opportunity to refinance into a new FHA-insured mortgage.

To protect FHA's MMI Fund, a line of credit in the amount of $8 billion has been set up to cover losses the fund might incur as a result of the FHA Short Refinances having a higher than normal default rate. The funds, from the TARP program, are available in the event any of the short-refis go into default. To date, there have been no claims filed for the short-refis and the program has not used any of the TARP funds.

—*Homeowner Bill of Rights.*—As another critical component to the recovery of the housing market, the President has also put forward a Homeowner Bill of Rights—a single, straightforward set of commonsense rules that families can count on when they're shopping for a mortgage, including the right to a new, simple, clear form for new buyers that gives people confidence when they're making the most important financial decision of their lives. And those rights shouldn't end when homeowners get the keys to their new home. When Americans lose their job or have a medical emergency, they should know that when they call their lender, that call will be answered and that their home won't be sold in foreclosure at the same time they are filling out paperwork to get help.

FHA servicing standards will be updated to incorporate the principles in the Homeowner Bill of Rights.

—*REO to Rental.*—A glut of vacant foreclosed properties continues to drag down property values and meanwhile, rental rates are rising as those who lose their homes to foreclosure seek rental housing, creating an unprecedented imbalance of supply and demand between the purchase and rental markets. This problem requires a creative, innovative mode of addressing the inventory of unoccupied homes in our communities. When there are vacant and foreclosed homes in neighborhoods, it undermines home prices and stalls the housing recovery. The administration began tackling this issue through the Neighborhood Stabilization Program (NSP) and our efforts have expanded our efforts through the REO to Rental initiative.

As part of the administration's effort to help lay the foundation for a stronger housing recovery, the Department of Treasury and HUD have been working with the FHFA on a strategy to transition REO properties into rental housing. Repurposing foreclosed and vacant homes will reduce the inventory of unsold homes, help stabilize housing prices, support neighborhoods, and provide sustainable rental housing for American families.

With about a quarter of a million foreclosed properties owned by HUD and the GSEs, this August, HUD joined with the Federal Housing Finance Agency (FHFA) and Treasury to issue a Request for Information (RFI) to generate new ideas for absorbing excess inventory and stabilizing prices. In all, about 4,000 submissions were received and, over the past several months, the interagency task force has been reviewing the submissions and formulating strategies based on the best practices gathered from the RFI. Throughout this process, the task force has continuously met with industry members, community groups, and other key stakeholders to make sure they are heard in the strategy development process. Ultimately, we expect a range of strategies to emerge; however the most commonly discussed centers around selling REO properties to buyers who will convert and market them as rental units.

Last week, Fannie Mae announced the first pilot program as part of the RFI, releasing details on its plan to sell homes that are part of its tenant in place portfolio. This is the first of a several collaborative efforts to clear the Nation's shadow inventory, an effort that FHA is an active part of. We plan to learn and leverage all we can from this initial pilot as we work towards conducting a series of additional pilots throughout the rest of the year.

—*Broad Based Refinance.*—Last, the President has called on Congress to open up opportunities to refinancing for responsible borrowers who are current on their mortgage but whose loans aren't backed by FHA or the GSEs. Under the proposal, borrowers with standard non-GSE, non-FHA loans will have access to refinancing through a new program run through FHA.

The program will be simple and straightforward. Any borrower with a loan that is not currently guaranteed by the GSEs or insured by FHA can qualify if they meet the following criteria—each of which is designed to help reduce risk to the taxpayer:

—They are current on their mortgage: Borrowers will need to have been current on their loan for the past 6 months and have missed no more than one payment in the 6 months prior.

—They meet a minimum credit score. Borrowers must have a current FICO score of 580 to be eligible. Approximately 9 in 10 borrowers have a credit score adequate to meet that requirement.

—They have a loan that is no larger than the current FHA loan limits in their area: Currently, FHA limits vary geographically with the median area home price—set at $271,050 in the lowest cost areas and as high as $729,750 in the highest cost areas.

—The loan they are refinancing is for a single family, owner-occupied principal residence. This will ensure that the program is focused on responsible homeowners trying to stay in their homes.

—They are currently employed. To determine a borrower's eligibility, a lender need only confirm that the borrower is employed.

Borrowers will apply through a streamlined process designed to make it simpler and less expensive for both the borrower and the lender. The President's plan includes additional steps to reduce program costs, including:

—Establishing loan-to-value limits for these loans. The administration will work with Congress to establish risk-mitigation measures which could include requiring lenders interested in refinancing deeply underwater loans (e.g., greater than 140 loan-to-value) to write down the balance of these loans before they qualify. This would reduce the risk associated with the program and relieve the strain of negative equity on the borrower.

Cost-Savings to the Borrowers Who Participate in This New Program.—Given today's record low interest rates, we estimate that on average, borrowers who participate in this program would reduce their monthly payments by between $400 and $500 a month.

Option To Rebuild Equity in Their Homes Through This Program.—All underwater borrowers who decide to participate in this refinancing program through the FHA outlined above will have a choice: They can take the benefit of the reduced interest rate in the form of lower monthly payments, or they can apply that savings to rebuilding equity in their homes. The latter course, when combined with a shorter loan term of 20 years, will give the majority of underwater borrowers the chance to get back above water within 5 years, or less.

To encourage borrowers to make the decision to rebuild equity in their homes, we are proposing that the legislation provide for incentives to borrowers who chose this option. Possible incentives include paying for closing costs or a lower MIP. To be eligible, a participant in this option must agree to refinance into a loan with a term of no more than 20 years and with monthly payments roughly equal to those they make under their current loan.

A Separate FHA Fund.—The broad-based refinance program will have a separate fund that is funded through premiums established and direct funding provided under this program with its net cost offset by the financial crisis fee. The program's premium structure will be designed in a way to ensure that homeowners have the incentive for lower monthly payments through the program. By maintaining a separate fund and funding source for this program the broad-based refinance will not be contingent on appropriations action and will have no impact on FHA's MMI Fund.

Expanded refinance options for homeowners with non-GSE and non-FHA loans, along with changes to the FHA Streamline Refinance, create a critical patchwork of refinance programs for responsible borrowers who are current on their mortgage loans. Through the efforts of HUD and its administration partners, working together with Congress, we can ensure that every family can have the opportunity to take advantage of today's historically low interest rates. This will save homeowners thousands of dollars a year, and as a result provide much needed payment relief and further strengthen the economy.

CONCLUSION

Madam Chairman, this budget reflects this administration's belief that the recovery of our housing market is essential to the restoration of our economy and that FHA is critical to restore health and confidence to the housing market in particular. By targeting resources where they are most needed, making tough choices in order to do more with less, and ensuring the protection of taxpayer interests, FHA's Single Family, Multifamily, Healthcare and Housing Counseling Programs, are ensuring more Americans have the opportunity to realize or maintain the economic security of the middle class. And the work this administration has done has established a strong foundation upon which we will construct an economy built to last.

Thank you.

FEDERAL HOUSING ADMINISTRATION—STREAMLINE REFINANCE PROGRAM

Senator MURRAY. Thank you very much for your testimony.

Let me start by asking you about earlier this week when the President announced changes to the FHA Streamline Refinance Program. FHA borrowers can already do streamline refinances, but the changes would reduce the costs.

Specifically, any borrower who is current on their mortgage and has a mortgage that was originated before June 2009 would pay an up-front premium, I understand, of .01 percent, and an annual premium of .55 percent? Normally borrowers would have to pay the current up-front premium of 1.75 percent and an annual premium of 1.25 percent.

This change has the potential to help borrowers enjoy the benefits of lower interest rates, but we are all focused on solvency of the MMI Fund. So, I am concerned about the impact of that change on that fund.

So, first of all, I wanted to ask you, who will benefit from this change, and how many you would expect to benefit? And second, what effect do you think that will have on the MMI Fund?

Ms. GALANTE. Thank you for the question.

So, there are a large cohort of borrowers who will benefit from this. Something in the magnitude of 2.5 million borrowers are eligible under those criteria that you mentioned. And these are people who are already paying 55 basis points on an annual basis for their mortgage insurance premium, so they will continue to pay the same amount and receive the full benefit, essentially, of a reduction in interest rate from wherever they are today, which obviously varies, but somewhere between 6.5 percent down to today's rates of around 4-plus percent.

So, there is significant benefit to them in monthly savings. Again, these are borrowers that already need to be current on the mortgages, so they are good, paying borrowers at this point in time. However, we all know that everyone is under stress in this economy, and if we can help those borrowers put some additional money in their pocket, we believe that over the long term, that strengthens their ability to continue to pay their mortgage payment, and does not cost FHA anything to get that essentially additional layer of security that they will continue to pay.

So, the only cost to this, really, would be the assumption that there were some people who would have refinanced at the higher mortgage insurance premiums, and we will not receive—there is an opportunity cost for not refinancing those people at the higher mortgage insurance premium. But in the mix, it is a very low amount to pay for that extra so-called insurance that doing the Streamline Refinance Program will benefit.

And with our other changes, the 75 basis points up front for all other borrowers combined, we will net between fiscal years 2012 and 2013 an additional $1 billion in premium increases.

Senator MURRAY. So, you do not see an impact on the MMI Fund, or you think it will benefit the MMI Fund.

Ms. GALANTE. I think, long term, it will benefit the MMI Fund. And with the up-front premiums that we are charging for the balance of borrowers, again, we believe we are going to net, in addition to what is already in the President's budget, $1 billion in budget receipts.

Senator MURRAY. Okay. When you announced the policy change, you also said some lenders are resistant to doing streamline refinances because they are concerned about how those loans might impact their performance assessments that are done through the Neighborhood Watch System. This system compares the performance of a lender's loans with other similar lenders.

And so, to ease those lenders' concerns, the new policy is to exclude those loans from the compare ratio. I certainly want to see more borrowers take advantage of low interest rates, but I also want to make sure we are monitoring FHA lenders. So, how can you ensure us that lenders will still be held accountable for poor performance?

Ms. GALANTE. Right. So, a very good question. And they will continue to be held accountable. Whoever originated that loan is still accountable for the origination. If there was fraud or there was a problem in that original origination of that loan, that lender can still be held accountable under our indemnification processes.

So, we do not think that that change will have a material effect on our ability to monitor lenders for their origination errors.

FEDERAL HOUSING ADMINISTRATION—MUTUAL MORTGAGE INSURANCE FUND

Senator MURRAY. Okay. The most recent quarterly report to Congress on the MMI Fund shows an increase in early period delinquencies for Streamline Refinance mortgages. That raises some concerns about the current proposal. However, the report does note that changes to the program have been made requiring lenders to certify income and employment at the time of refinance.

Can you explain the changes that you made to the program requirements and what impact you expect that to have on the performance of Streamline Refinance loans going forward?

Ms. GALANTE. So, when the Streamline Refinance was first being used in the beginning of this crisis, there were not some of the controls that you just mentioned on the program. Putting those controls in, we believe, will significantly help the re-default ratio of those loans.

It is true that people who are being refinanced because they are under some kind of stress, even though they are current on their mortgage, may have a slightly higher default ratio than other people. But on the other hand, we are going to be better off if they do not ultimately default because we have lowered their interest rate. If we can help them stay out of default by lowering their interest rate and putting more money in their pocket, ultimately, we are going to benefit from that.

Senator MURRAY. Okay. When the Secretary was here last week, we spent a bit of time talking about the health of the MMI Fund and the current expectation that an appropriation will not be needed to cover the re-estimate.

In the past few weeks, there have been a lot of numbers released on the MMI Fund related to all the various settlements and premium increases. And I understand that the settlements have not been filed in court, so these numbers still are not final. But if you could, can you give us just a walk through on what has happened and where we see these, including the premium increases in various settlements, and the impact on the MMI Fund?

Ms. GALANTE. Right. So, the budget projection in the President's budget was that if there were no additional policy changes and MIP (mortgage insurance premium) increases, and no additional funds through enforcement actions, and the economics that the projections were based on stayed the same and the volume stayed the same, that we could need to draw $688 million from Treasury.

Given the policy changes in the premiums, which will generate, as I said, over fiscal year 2012 and into fiscal year 2013, more than $1 billion of receipts, and the approximately $900 million that comes from the settlement negotiations, those two things obviously take away the need for the $688 million and leave us in the plus category to some degree.

Now, all of this is based on assuming that there is not any major change in our volume from the projections that were in the President's budget, or from some other worsening of economic conditions.

So, there is still some risk, and we do not pretend that there is not. But it is much less likely given the policy changes that we have put into place.

Senator MURRAY. Okay. Thank you very much.

Senator Collins.

Senator COLLINS. Thank you, Madam Chairwoman. I want to follow up on the very issue that you were just discussing with Senator Murray. It does appear that the FHA, contrary to the projections in the President's budget, will narrowly avoid requiring funds from the Treasury in this fiscal year. But there are circumstances under which these steps that have been taken, such as the increase in mortgage insurance premiums and the funds from the settlement, might not be sufficient to keep the FHA from requiring an infusion of cash from the Treasury.

You mentioned broader economic issues. But if you could be more specific on what could cause the Treasury, to be needed after all, despite the insurance premium increase and the settlement funds.

Ms. GALANTE. So, I think the major issue is if house prices decline and they decline significantly from the projections both under the President's budget and from our actuarial, which had different projections. So, there is a range here.

But the fact is, everyone is at risk of where house prices are going relative to the whole economy. We are starting to see some stabilization there. We are starting to see some good signs. But we have seen the beginning of some good signs before, and so we do not want to take that for granted, that it is just absolutely going to turn the corner here.

So, we are continuing to do everything that we can, including increasing premiums, including additional enforcement actions. The settlements that you have seen are not necessarily the end of FHA's enforcement actions to keep lenders accountable.

We are also making changes in our REO processes, as has been widely publicized. Again, if we can recover more dollars as we dispose of our REO, if we can stabilize the housing market through those kinds of actions, all of that will ultimately help the MMI Fund.

So, we are going to continue to monitor this very closely. We are going to continue to take additional actions that we need to take to keep the fund healthy.

MORTGAGE INSURANCE FEES

Senator COLLINS. But it seems that the administration is going in contrary directions when it comes to fees and mortgage premiums. On the one hand, you are increasing the premiums, but as part of the FHA's Streamline Refinance Program, you are actually substantially reducing fees and premiums.

Now, I recognize that that is great news for hundreds of thousands of families, potentially lowering their monthly payments. But that obviously has a negative impact, I would think, on the FHA's capital reserves.

Now, you said in response to a question from Senator Murray that ultimately you think that it is going to benefit the fund. I am trying to understand how cutting the fees will benefit the fund. Is it that you expect to make it up in volume? It seems inconsistent with your overall approach of increasing premiums.

Ms. GALANTE. So again, this does get a little bit confusing. But these are borrowers who are already in our portfolio, who are paying 55 basis points on an annual basis today.

And what we have done under the Streamline Refinance that was announced this week is we have said, if they want to refinance at today's current interest rates, essentially they get to keep the same premium that they have as opposed to having to pay the new current premiums that we have increased, not just this past week, but that we have increased over the past 3 years.

And so, if they had to pay those higher premiums, the $175 up front and 1.25 points over time, that would so significantly cut into their net benefit on a monthly basis that many of them simply would not choose to refinance. So, they would just stick where they are, and they would in some ways be a higher risk to us because they are paying a higher interest rate today, and they are not being able to take advantage of the lower interest rate.

So, that is why we really believe that this is different than charging new borrowers for higher mortgage insurance premiums.

Senator COLLINS. I understand that, but are you not actually cutting their fees compared to the fees that they are currently paying? I understand they are not going to have to pay the higher fee, but it was my understanding that you were going to cut the annual fee in one-half and cut the up-front insurance premium costs from 1 percent of the loan balance to .01 percent.

Ms. GALANTE. So, here is where it gets a little difficult. For the current borrowers, they are already paying that 55 basis points. What we are saying is we are not going to jack you up to the higher mortgage insurance premiums. And we had been doing that to other borrowers. That is how we have been running this program until June 1 when we have this go into effect.

So, it is not cutting the existing borrowers' fees. It is that they will not have to pay the higher fee, if that makes sense.

CAPITAL RESERVES

Senator COLLINS. Let me move to the statutorily mandated level of 2 percent for the capital reserves. This really troubles me because this is not a guideline. It is not a best practice. It is not a suggestion. It is not a recommendation. It is the law. And for the third year in a row, FHA has not met that level.

Now, I understand why, and the total collapse of the housing market—and I know that you are putting in new premium increases and proposing new rules related to lender oversight. I guess my question is, are you confident that that is going to be adequate?

I do not think you should be relying on a one-time windfall from the lender's settlement to get you back to the statutorily required level.

Ms. GALANTE. So, we certainly are not relying exclusively on the settlement funds to get us back to the level. I mean, $900 million is not going to get us back to a 2-percent capital reserve. That is why we have been over the past 3 years increasing mortgage insurance premiums significantly.

So, we have between the start of this administration and the premium increases announced last week, we have doubled the mortgage insurance premium on FHA loans. And we are financing borrowers at very low interest rates. Those loans are going to stay with us and continue to be paying a mortgage insurance premium for many years to come.

And we are not going to get there up to the 2-percent capital reserve in 2013. It is going to take a couple of years of the loans that we have and that we have put this additional premium increase on. It is going to take a couple of years to late 2014, early 2015, before we project we will back to the 2 percent. And it is not a result of just the settlement. It is a result of these ongoing increases in premiums to help us get there, as well as other activities, other policy changes that we are making.

RISK ASSESSMENTS TOOLS

Senator COLLINS. Thank you, Madam Chair.

Senator MURRAY. Clearly the re-estimates are going to be impacted by the conditions in the market that is outside, has control, if prices of homes decline or whatever. I think everybody understands that. But we also know that HUD has to work to improve its ability to monitor its risk and its estimates. And the Government Accountability Office (GAO) has recommended improving your risk assessment tools to better incorporate the risk of future economic volatility.

In years past, the Congressional Budget Office (CBO) has raised concerns about your estimates, and I understand that you currently have a contract that will allow you to use stochastic modeling in the next actuarial review.

Can you explain how that modeling is different than what you are doing today, and how that will change your estimates?

Ms. GALANTE. Sure. I will take a stab at it. We, first of all, appreciate the help that Congress has given us in funding a number of important initiatives that help us get the modeling as up to date as possible.

And stochastic modeling allows us to really have more dynamic scenarios built in, more variables built in, to monitor many different increases and changes in market conditions. And so, it will enable us to have many more points of range of—under different economic conditions, what happens?

So, it is going to provide us significantly more information than we have under the current modeling. But I would also say the modeling has been improved over the past couple of years. It has not been a static situation.

Senator MURRAY. Does that address the concerns that GAO outlined for you?

Ms. GALANTE. I believe so, yes.

Senator MURRAY. In your testimony, you said HUD has clarified the rules around lender indemnification for insurance lenders. What aspect of the rules did you feel were important to clarify, and what effect will those changes have on enforcement going forward?

Ms. GALANTE. So, the most important thing was to define material and serious violation so that lenders—this cuts two ways—lenders will know that we are not going after minor little box checking errors, but it is clear what they will be held accountable for. So, that helps them understand the standard that we are going to be looking at. So, that was the most important thing.

Senator MURRAY. Okay. You expressed an interest in getting two additional authorities to strengthen FHA's enforcement abilities, including lender indemnification requirements to direct endorsement lenders, and expanding your authority to remove lenders from the program on a national basis. Can you explain why those different rules currently apply to those different classes of lenders, and what impact those proposals will have on your enforcement?

Ms. GALANTE. So, right now the indemnification rules apply to our lender insurance program, which covers, I think, 70 percent of our volume, but only 30 percent of our lenders. So, we kind of have a reverse situation here where the largest lenders doing the most amount, we can get indemnities from. But for the smaller lenders who are direct endorsers, we do not have that authority. So, that would be a smaller volume, but it is still important to be able, in our view, to have the same authority for both types of lenders. So, that is one statutory requirement that we would like.

The other is, right now, it is incredibly cumbersome to go after lenders when we see a systematic problem with a lender that operates in multiple jurisdictions, because we need to look at their offices on a geography by geography basis and what problems they have in that office. So, this makes it very hard when we are in the 21st century where lenders are operating all across different geographies, and our statutory requirements have not really kept up with the need to have that kind of systematic overview.

Senator MURRAY. Okay, good. And the HUD Office of Inspector General has recommended that you seek legislative and program changes to prevent lenders and their corporate officers from reentering the program as an officer with the same or a new lender. Is that a recommendation you agree with?

Ms. GALANTE. We do conceptually agree with that. We have got to figure out exactly what the legal statutory language would be to walk a path of ensuring that we are keeping the bad guys out from just coming in the back door with another lender, but not trapping everybody who has worked for an institution, for example, that had issues, but perhaps were not directly involved in the——

Senator MURRAY. So, the concept you agree with.

Ms. GALANTE. The concept we absolutely agree with.

Senator MURRAY. The language, we have to be careful with.

Ms. GALANTE. Correct. That is correct.

REAL ESTATE-OWNED PROPERTIES

Senator MURRAY. Okay. As a result of foreclosures and home price declines, the rental housing market is really tightening. So, on the one hand we have an excess supply of distressed housing, and on the other we have increased demand for rental housing and a shortage of affordable housing.

Last August, FHA, Treasury, and the Federal Housing Finance Agency put out a request for information to determine interest in a proposal to sell distressed properties more systematically.

FHFA recently announced a pilot sale of real properties, which would include the sale of 2,500 properties in bulk. Your testimony mentioned that following that pilot, FHA would do its own. What, specifically, is HUD considering in terms of a pilot, and do you have a timeframe on that?

Ms. GALANTE. So, yes, thank you. There are a couple of things we are doing on that. The first is the Fannie pilot; the initial pilot is for properties where they had already tenants in place, and so it is a little bit separate from the rest of the REO-to-rental strategy that we are, as FHA, also working with FHFA and Government-sponsored enterprises (GSEs) on. And we, together, are looking at other pilot communities where all three of us—it might make sense to have a pilot where there is stock from each of those institutions, because one of the things we are trying to get to is ensuring that there is a reasonable number of units in a geography so that someone could actually own and manage these homes as rental housing in a cost-effective manner.

Frankly, all of us have been working down our REO at the moment, and so there are limited geographies where it makes sense to do this all together. So, we are identifying those places, and I would hope in the next month or two that we would be able to announce where we would want to continue to work together.

FHA is doing some other things on its own. We are interested in ramping up our Notes Sale Program. And without getting into the details, that is essentially a pre-REO sale of the note with the existing borrower in place. And then whoever buys that note has the opportunity to and requirement to work that borrower, maybe rent them back, maybe put them in a lease-to-own. There are a variety of mitigation measures that they can do before the property reaches REO, because by that point, we are already losing a significant amount of money. So, there are a number of other things that we are working on around that pilot.

Senator MURRAY. Okay, great. Appreciate it.

Senator Collins.

Senator COLLINS. Thank you, Madam Chairwoman.

The administration has proposed paying for its broad-based refinancing plan by charging a fee on large financial institutions, a so-called bank tax.

This fee has previously been proposed and rejected by Congress. When Secretary Donovan was before us, and also in an interview that he gave with reporters, he said that while he personally believes the fee is the right approach, HUD is open to exploring alternatives.

What alternatives is HUD looking at?

Ms. GALANTE. So, Senator, I would say I do not have a particular alternative to put on the table. The President's proposal does include the financial responsibility fee. If there are other ideas—I think what we are saying is that we are open to consider other alternatives for this. But it is important, back to the health of the FHA fund—we really think it makes sense to do this broad-based refinance program, but we also think it is important to have segmented from the MMI Fund, and whatever risk is in that fund to be funded from a separate pot of money.

Senator COLLINS. I would suggest to the administration that since this proposal did not go anywhere in the past, that it would be really helpful if you came forward with other approaches that might be better received. I told the Secretary that too. I know it is a little bit out of your lane, but I did want to bring it up today.

Madam Chair, I am going to submit the rest of my questions for the record because I do have to go to the floor to present an amendment.

Senator COLLINS. But thank you for holding this important hearing. And Ms. Galante, thank you for being here today.

Ms. GALANTE. Thank you.

Senator MURRAY. Thank you very much, Senator Collins. And I just have a couple of questions left, and I appreciate your answering. Many of our questions we will have to submit in writing today.

UNDERWATER MORTGAGE RELIEF

Senator MURRAY. We are beginning to see signs of life in this housing market, but there are still some looming concerns, especially about the number of underwater mortgages and the shadow inventory that is eventually going to hit the market. The settlement with those five largest servicers includes $17 billion in direct consumer relief that will be provided to borrowers through help, like principal write-downs and short sales. It also includes $3 billion to support mortgage refinancing for underwater borrowers.

I wanted to ask you how you expect the servicers to allocate the direct consumer relief among various relief options, and what do you expect the impact of that $3 billion to be?

Ms. GALANTE. So, again, I think some of this is going to be worked out over time. Each servicer has an allocation of the $3 billion of refinancing and the $17 billion in principal reduction and other consumer relief. And they have allocations based on a State-by-State basis.

So, we do expect that—the combination of all of those menu of services across the country will help somewhere in the magnitude of 1.7 million owners through a variety of those activities. And it is going to depend on what their individual portfolio looks like, what State they are in, and a number of other factors.

Senator MURRAY. So, we could see a different picture and different——

Ms. GALANTE. Different picture in different States and by different institution depending on, again, what kind of borrowers they have in their portfolio.

MORTGAGE SCAMS

Senator MURRAY. Okay. And finally, I wanted to ask you about mortgage scams. An important part of the recent settlement is that it provides relief to homeowners. But throughout this housing crisis, we have seen a lot of scam artists who are preying on vulnerable homeowners. And those perpetrating those scams have been incredibly skilled at adjusting their tactics as new opportunities arise. Are you concerned that scam artists could try and take advantage of homeowners who may be eligible for relief through this settlement?

Ms. GALANTE. We are concerned, not just about the settlement, about that, but more broadly. When I was out at the event with the housing counselors that I mentioned in my testimony, that was one of the big things I heard, that the housing counseling community is trying to stay ahead of the scam artists. And, they get people who come into them after they had been taken advantage of. And it is a serious problem.

I would say that we have a campaign that we are working with a number of other agencies and nonprofits that is a consumer education campaign. And in fact, this week is National Consumer Protection Week, and we are launching a campaign down in Atlanta today actually. The press release probably is coming out today. It is called Know It, Avoid It, Report It, and there is——

Senator MURRAY. Know, Avoid It, Report It?

Ms. GALANTE. Know It, Avoid It, Report It. So this is reaching out to borrowers to make sure that they understand that there are scam artists, and if they see it, if they are being asked for money to do certain activities, there is a number they can call. There is a Web site they can go to to report the scams that they are seeing.

Senator MURRAY. Okay. I urge you to be really aggressive on that because these scam artists are really aggressive and stay ahead of us. So, I appreciate that, and we will be following that closely as well.

Ms. GALANTE. Right.

ADDITIONAL COMMITTEE QUESTIONS

Senator MURRAY. I believe that is all the questions that we have for you at this time. Again, we will leave the record open for additional questions and your comments back.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR PATTY MURRAY

EVALUATING RISK

Question. Given the volume of loans that FHA insures, it is critical that it has the capacity to monitor and assess risk. Two important aspects of this are: Staff with the appropriate expertise, and modern IT systems. In the fiscal year 2012 bill, the committee set aside $8.2 million for the Office of Risk and Regulatory Affairs to support increased risk controls. What is the current status of this relatively new office?

Answer. Led by a Deputy Assistant Secretary with extensive experience in assessing credit risk, the Office of Risk Management and Regulatory Affairs (ORMRA) recently received its delegation of authority to carry out, in concert with program offices, all risk management, analysis, and evaluation functions, including decisions and corrective measures related to risk assessment, risk management strategy, and risk governance policies. With several credit risk officers already on staff, the office is in the process of hiring additional staff with credit risk and operational risk expertise to ensure that there is sufficient coverage and expertise to review and report risk across all FHA platforms.

The Office of Risk Management and Regulatory Affairs is authorized to conduct risk management and risk assessment activities including, but not limited to the following:

—Recommend actions to support FHA's ability to reduce risk exposure to its insurance funds while meeting its housing mission and operating in compliance with statutory capital requirements;

—Promote transparency and comprehensive communication of FHA's risk profile by establishing reporting metrics for key constituents, both internal and external, in order to communicate, both qualitatively and quantitatively, FHA's risk levels, trends, priorities, risk mitigation activities, and impacts;

—Identify the policies and processes that are key drivers of risk via a structured risk identification framework: I.e., recommend risk mitigation strategies for FHA and specific program areas and provide independent oversight and assessment of risk remediation activities; provide input and guidance to program areas on key risk analytics, policies and practices, including, but not limited to, algorithms and underwriting used to identify, measure, and manage risk-related to endorsement and management of Single Family, Multifamily, and Healthcare programs, and collaborate with program areas regarding counterparty risk (lenders and servicers), portfolio asset management strategies, and enforcement practices to protect FHA's insurance funds;

—Design and maintain a comprehensive Risk Governance infrastructure, including implementing policies, processes, and committees to reduce risk exposure to the insurance funds; i.e., advise and provide oversight for the implementation of policies, processes, and committees that comprise the governance structure;

—Ensure the timely and proper conduct of statutorily mandated and other necessary risk analyses, including the annual actuarial study of the Mutual Mortgage Insurance Fund and front-end risk assessments (FERA) for new and high-impact programs and activities, in accordance with Federal standards, and in concert with other Office of Housing offices; and

—Ensure that risks are measured, monitored, and managed according to an integrated framework across FHA and Office of Housing program areas.

In order to carry out its functions, the ORMRA has instituted monthly credit risk committees with each FHA program office to evaluate loan performance data and make informed policy decisions which account for risk. In addition, the Office is utilizing the work of FHA Transformation to create and obtain monthly reports based on various model scenarios that will allow FHA to evaluate the health of the FHA fund on a more regular basis throughout the year.

ORMRA's Office of Evaluation assesses the financial impact of new or revised HUD/FHA programs and policies; new or proposed legislation; and/or new or proposed directives, studies or rules of the Office of Management and Budget (OMB), the Government Accountability Office (GAO), the Department of the Treasury (Treasury), or other agencies. The Office of Evaluation is responsible for actuarial analyses and cash-flow projections of the FHA insurance funds and evaluates relationships between current market conditions and FHA program goals and objectives. The Office of Evaluation estimates the financial impact of policy changes or external factors on FHA programs. In addition, that Office conducts a quarterly analyses of economic developments and ongoing portfolio analyses of FHA's insurance funds.

The operational risk team within ORMRA has begun adopting GAO's recommendations from its November 2011 Report on Improvements Needed in Risk Assessment and Human Capital Management. This includes employing stochastic modeling for the 2012 actuarial report. Recently, the Office briefed GAO on its accomplishments to date in connection with such report.

Question. GAO has noted the importance of integrated and updated risk assessments to the solvency of the Mutual Mortgage Insurance (MMI) Fund. Will the Risk Office assist in more integrated risk assessments?

Answer. Yes, the Office of Risk Management and Regulatory Affairs (ORMRA) will assist in more integrated risk assessments. ORMRA is leveraging the current process utilized by the Office of Single Family Housing in its quarterly Internal Quality Control Reports to populate a baseline operational risk assessment. This baseline operational risk assessment will be used in conducting the annual risk assessment. ORMRA and Single Family will partner in conducting the annual risk assessment so that it is a more integrated and coordinated effort. In addition, ORMRA and the program offices plan to hold quarterly operational risk committee meetings to review the Internal Quality Control Reports, the risk assessments, and monitor the remediation plans.

Question. Modern IT systems are necessary for FHA to assess risk effectively. Unfortunately, many of HUD's IT systems are decades old. This committee has provided HUD with millions of dollars, primarily through the Transformation Initiative, to modernize FHA systems. What is the status of that project? And when can we expect to see the benefits of these updated systems?

Answer. The project is maximizing the funds appropriated by Congress to the greatest extent. We have completed several studies documenting a roadmap to follow for implementing business services on the Federal Financial Services Platform. We have identified the required Risk and Fraud tool, along with a Portfolio Evaluation tool. Procurement and deployment of the tools are underway. We need funding in fiscal year 2013 and beyond to continue to implement the vision of FHA Transformation which is a priority of the committee.

Benefits of the FHA Modernization capital investment are being realized today. Acquisition of the Federal Financial Services Platform (using Oracle Exalogic hardware, featuring the integrated Fusion Middleware software stack) is the cornerstone IT investment. This platform ultimately has enterprise extendibility and provides the capability and capacity to replace the Unisys and IBM mainframe systems at some logical point in the future. Eighty percent of the initial planned environments are built out on the Oracle Exalogic platform; 100 percent by August 31, 2012. A requisition for additional Oracle Exalogic hardware/software is in the procurement pipeline. This additional capacity positions us to accept requirements from other offices in the Department (e.g., Public and Indian Housing (PIHs), Next Generation Management System (NGMS) projects); accordingly, this achieves true enterprise capability and demonstrates scalability. The Lender Electronic Assessment Portal (LEAP) application consists of four modules (i.e., Approval, Recertification, Monitoring and Enforcement) that are in various stages of development and production. Today LEAP automates what largely has been a manual and paper intensive process. The LEAP application wholly aimed at improved counterparty (i.e., lender) management, addresses vestiges of risk and fraud at the front end (or origination) of the loan rather than relying on the antiquated process during the post-endorsement process. The Approval module went live in April 2012 and is successfully processing a steady state volume of request. The Recertification Generation I module is slated for operational capability in the second quarter of fiscal year 2013 with design and development of the other modules in the ensuing months; LEAP is projected to achieve full operational capability in the first quarter of fiscal year 2014. Consistent with addressing significant constraints on risk and fraud detection, the Loan Review System (LRS), Portfolio Evaluation Tool (PET) and Automated Underwriting System capabilities are slated to achieve operational capability in early fiscal year 2014. This complementary set of tools and capabilities effectively provide decision support (and analytics) at every step in the process of the loan lifecycle, from origination through post-endorsement technical review.

Question. Given FHA's significant presence in the market, the systems FHA uses to conduct its business are constantly in use. Therefore when new systems come online, transitioning from the existing systems to new ones will require careful planning. What are your plans for making sure that the transitions to new systems are as smooth as possible?

Answer. FHA will continue to fully embrace HUD's Project Planning and Management (PPM) framework. New system deployments will be coordinated with all stakeholders to minimize disruptions and training costs. FHA will assess the operational readiness of each system, prior to its "go live" phase. Consistent with the PPM methodology, FHA will so document and detail the plans and procedures to decommission legacy systems as they are no longer needed. Launch of the business services will follow the industry best practices of beta testing, soft launch and full scale launch. Appropriate communications will be shared with users of the business services, to include citizens.

QUESTIONS SUBMITTED BY SENATOR ROY BLUNT

FHA'S SOLVENCY

Question. As one of the only games in town, the Federal Housing Administration (FHA) continues to have a ballooning portfolio, well above the intended size. The administration's white paper proposes various reform options for the Government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. How can the Department of Housing and Urban Development (HUD) ensure that FHA won't become the lender of last resort for home loans should the private market move slowly, if at all, to fill the space it once filled?

Answer. The administration is currently working diligently on a number of interagency projects set forth in the white paper that was published in February 2011, including a detailed exploration of the three options for the future of housing finance. Of those three options, the third one does provide considerations around maintaining some Government presence through a model that would serve as a back-stop in the form of reinsurance behind significant layers of private capital at a guarantor level. Below is greater detail on the strengths and weaknesses of this third option. However, to be clear, the administration is still working with a number of stakeholders, including Members of Congress, to fully explore all three.

At the same time, the administration is equally engaged on topics that directly involve the GSEs, such as the development of national servicing standards, a transition plan for the wind down of Fannie Mae and Freddie Mac from their current status and reducing the footprint of the FHA. It is important to remember that the FHA and GSEs continue to provide an important source of credit availability as Government and industry work collectively to reduce the barriers of uncertainty that block a robust return of private capital. Thus, while the administration supports decreasing the role of FHA, Fannie Mae, and Freddie Mac and re-invigorating the private market, we also believe that any approach must be measured and comprehensive to address the tensions your questions above elicit.

Question. The administration's budget once again requests increases in MMI premiums to help strengthen the fund. While I'm encouraged by the increase in liquidity to protect against risk to the solvency of the fund, I question whether the already bloated portfolio will grow in 2013 rather than shrink as your budget assumes. What steps are being taken to encourage private lenders to originate quality, non-FHA insured loans? How can HUD encourage the private market to provide home loans for minorities who disproportionately rely on FHA's Government guarantee?

Answer. In February 2012, HUD announced an increase in FHA annual and upfront mortgage insurance premiums, effective in April 2012. The decision to adjust FHA premiums for the fourth time since 2009 was made by balancing several factors—FHA's mission of providing access to credit for low-wealth, creditworthy borrowers, the health of the Mutual Mortgage Insurance Fund and FHA's long-term role in the Nation's housing finance system. As a result of these premium adjustments, FHA has been able to continue to serve its counter-cyclical role in the mortgage market—providing access to credit to creditworthy borrowers during this time of market constriction—but has seen overall volume decline. According to Amherst Securities' June 14, 2012, Amherst Mortgage Insight Report, the composition of FHA loans in Ginnie Mae securities has actually declined. This is in large part because these pricing changes have made conventional loans more competitive; high FICO borrowers who may have chosen to take out an FHA insured loan rather than a loan with private mortgage insurance are now finding the costs of private versus federally backed mortgage insurance more comparable. However, adjusting premiums is only one lever. Currently, FHA is the only federally backed institution able to originate high-priced loans (loans above $625,500). As a result, borrowers seeking these "jumbo" loans only have one outlet—FHA. In its housing finance reform white paper, the administration urged Congress to allow the higher loan limits to expire. Unfortunately, in November 2011, Congress elected to extend these limits for FHA while allowing the GSE loan limits to go back to pre-crisis levels. This does create a disincentive to originate non-FHA loans in some markets and so we would once again urge Congress to allow FHA loan limits to step back to the HERA levels.

COMMERCIAL LENDING

Question. In my home State of Missouri, we have a large man-made lake with a substantial volume of lakefront properties, as well as continued commercial development. That said, HUD continues to promote mixed-use properties as needed housing stock diversity for communities. FHA's condo rules prohibit the purchase of a condominium in a property with more than 25 percent commercial space. What is the purpose of this restriction, and doesn't it run contrary to the new "town center" model that HUD is promoting?

Answer. While FHA's requirement regarding permissible commercial space is less restrictive than the industry standard of 20 percent, and FHA has provided for an exception to 35 percent for those projects meeting additional eligibility criteria, we have been working on changes to our requirements that will better accord with the growing trend of mixed-use development while simultaneously managing risk to FHA. Prior to recent changes in the housing market, mixed-use properties were not submitted for FHA condominium project approval. Now that they are subject to FHA project approval, FHA must develop standards for approval of these projects. Until standards are fully developed, these projects are reviewed on a case-by-case basis, taking into consideration that they tend to be riskier and often times the primary use is more non-residential than residential. Therefore, there is a need to review these projects carefully to ensure that approved projects contribute to FHA's mission of providing affordable, sustainable housing opportunities while balancing the risk to the Mutual Mortgage Insurance Fund. We expect to issue updated guidance regarding mixed-use development very soon.

APPRAISALS

Question. In my office, we often hear concerns from prospective buyers, builders, lenders, and other industry representatives about serious problems with the FHA appraisal process. Are you receiving complaints at your agency? Are you concerned with the current appraisal environment?

Answer. Consumers and realtors may often have value issues with appraisals that complicate transactions they are involved with, but it is important to recognize that both parties have a vested interest in the properties they seek to purchase and/or sell. Appraisers, by law, are required to comply with the Uniform Standards of Professional Appraisal Practice (USPAP), which, among other standards, requires appraisers to perform assignments with impartiality, objectivity, and independence. The appraiser's role as a disinterested third party is to provide an unbiased opinion of value. This may, at times, be at odds with the negotiated contract purchase price, which while reflective of market activity may not reflect market values in a given area. Appraisal issues tend to center around a perceived inability of the consumer or realtor to be able to communicate directly with the appraiser because of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010, which prohibits undue pressure on the appraiser, and a separation of production and compliance in the lender's operation. This has caused some confusion in the markets regarding what is allowed in terms of communication to the appraiser among all parties to the transaction including the appraiser. FHA has released guidance to appraisers and lenders through the release of Mortgagee Letter 2009–28 (entitled Appraiser Independence) to clarify what is acceptable.

Question. Also, what appeal process, if any, exists when homes that were appraised far below or above another appraisal? What appeal process exists for builders or lenders when an appraiser values a home well below the price offered and under contract?

Answer. The mechanism for an appraisal appeal is known as a reconsideration of value. A reconsideration of value is a request to the FHA Roster appraiser to reconsider the analysis and conclusions of his or her appraisal based on information that was not presented on the appraisal report, but was relevant to the appraisal and available to the appraiser in the normal course of business as of the effective date of the appraisal.

Only the lender's underwriter can request a reconsideration of value from the FHA Roster appraiser. Information regarding comparable sales, listings, or under-contract-of-sale properties that the appraiser did not cite in the appraisal report but was available to the appraiser in the normal course of business as of the effective date of the appraisal are appropriate data to be provided to the appraiser. The appraiser is required to consider the data provided by the lender. The reconsideration may or may not result in an amended report. The underwriter should include all relevant data with the request for the reconsideration. Information available at the time of the appraisal but not provided in the original report should be in the appraiser's file.

TREBLE DAMAGES

Question. The GSEs and other major mortgage investors require lenders to repurchase loans that do not meet their underwriting or servicing guidelines. FHA has additional authority, under the False Claims Act and the National Housing Act to assess treble damages on lenders for origination and servicing violations. Clearly, lenders who commit fraud should be penalized and barred from participating in the FHA program. But for more routine mistakes, repurchases and indemnification exist as a remedy.

For large institutions, treble damages on enough loans would be a significant business cost, but for smaller lenders the impact is even greater if they have to pay three times the claim amount. Small, independent mortgage bankers are struggling with compliance business costs that they incur now because of increased industry regulation.

My concern is instances where lenders acted in good faith and there was no fraudulent activity. For some of the smaller lenders, the cost of simply defending themselves could be devastating. Can you tell us under what circumstances FHA would see itself using this more stringent authority rather than having lenders simply repurchase or indemnify loans?

Answer. FHA is an insurer; it does not own loans originated by FHA-approved lenders. Therefore, repurchase is not a means for resolving violations of FHA origination, underwriting, or servicing violations. In instances of material non-compliance, HUD often attempts to settle with the lender by obtaining an agreement from the lender to indemnify FHA against losses. Indemnification may also be compelled under HUD's Lender Insurance Program in response to violations of HUD's origination and/or underwriting requirements. Since 2010, FHA has pursued statutory authority to extend this indemnification authority to FHA-approved Direct Endorsement Lenders.

With respect to treble damages, section 536 of the National Housing Act (12 U.S.C. sections 1735f–14) authorizes HUD to impose a penalty in the amount of three times the amount of any insurance benefits claimed by the mortgagee for any mortgage where the servicer has failed to engage in loss mitigation in compliance with HUD's requirements. Imposing treble damages under this authority requires a demonstration that the lender has acted knowingly (demonstrated through evidence of actual or constructive knowledge) and that the misconduct is material. HUD regards treble damages as appropriate only for egregious violations of its requirements, and has not yet imposed treble damages for servicing violations.

The Department of Justice (DOJ) has authority under the False Claims Act to pursue treble damages for, inter alia, knowingly presenting or causing to be presented false claims to the Government or making false records to get a false claim paid. The False Claims Act is only employed where there is evidence of fraud.

While the size of the lender bears no relationship to the extent of its misconduct or, as a result, the amount of damages and penalties sought, both HUD and DOJ consider the lender's ability to pay in the context of settlement discussions.

Question. Has FHA considered how the indemnification polices and the penalty of treble damages impacts smaller lenders versus larger lenders?

Answer. When HUD's Mortgagee Review Board (MRB) is determining the appropriate penalty to impose upon FHA-approved lenders who have violated FHA's requirements, and when HUD's enforcement lawyers are negotiating settlements with lenders who have violated FHA's requirements, HUD consistently takes into consideration the lenders' abilities to pay the proposed penalties.

Question. How do you see FHA striking the right balance between fighting fraud while ensuring that honest lenders are not discouraged from participating in FHA programs? Does FHA have the authority to cease business with known bad actors?

Answer. HUD, along with DOJ, have powerful enforcement tools to wield against those attempting to defraud the Federal Government, but employs these only in cases where there is evidence of fraud or knowing and material violations of HUD's requirements. Moreover, HUD's enforcement procedures provide lenders with considerable due process. Lenders receive written notices of HUD's findings and the underlying basis for those findings. Lenders then have the opportunity to respond and, if appropriate, to resolve the issues through, inter alia, provision of mitigating information or an agreement to indemnify HUD against harms before any enforcement action is taken. It is only in those instances when the matter cannot be resolved without enforcement actions that the case is referred to HUD's Mortgagee Review

Board (MRB). HUD's MRB, after a thorough review of the violations and any preliminary responses from the lenders, issues a formal notice of its intent to pursue sanctions, if any, and provides additional opportunities for lenders to dispute and/ or settle HUD's allegations. If the MRB determines that penalties are appropriate, HUD's enforcement lawyers initiate administrative proceedings, which enable lenders to dispute HUD's determinations before administrative law judges.

The substantial due process outlined above assures entities that abide by HUD rules that they will have sufficient opportunity to show that any actions that may cause concern do not rise to the level of fraud or knowing and material violations while still deterring bad actors with the threat of sanctions. If HUD obtains sufficient evidence of misconduct by a "bad actor," and that evidence warrants suspension or withdrawal of the lender's approval to participate in FHA's programs, HUD's MRB has the authority to suspend or withdraw the lender's FHA approval. Any such action by the MRB is subject to adjudication before administrative law judges and review by the Federal courts.

SUBCOMMITTEE RECESS

Senator MURRAY. But I appreciate your testimony, and your time, and your staff today. And with that, this hearing is recessed. Thank you.

Ms. GALANTE. Thank you very much.

[Whereupon, at 10:56 a.m., Thursday, March 8, the subcommittee was recessed, to reconvene subject to the call of the Chair.]