TRANSPORTATION AND HOUSING AND URBAN DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 2012

THURSDAY, APRIL 7, 2011

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

The subcommittee met at 9:30 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Patty Murray (chairman) presiding.
Present: Senators Murray, Collins, and Blunt.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FEDERAL HOUSING ADMINISTRATION

STATEMENT OF HON. SHAUN DONOVAN, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OPENING STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. Good morning. The subcommittee will come to order.

And I want to thank everybody in advance for—we're going to really confine everything this morning. I have a leadership meeting this morning, as everyone knows. The elephant in the room of the Congress today is how we are going to come to agreement and avoid a shutdown. It's absolutely critical for families, for our country, for all of us to come to that agreement. So I will have to leave here shortly before 10:15 a.m. So, I'm going to consolidate my opening statement. I know the Secretary's agreed to this as well, as well as Senator Collins. And we will get to the critical questions of the day and submit many for the record.

So, Mr. Secretary, thank you for your understanding.

Senator Collins, thank you for working with us as well. And I will make a short opening statement.

This morning we are holding a hearing to get an overview on the Federal Housing Administration (FHA) and talk about the future of housing finance. And I again want to welcome Secretary Donovan back before this subcommittee to talk about these important issues.

In the aftermath of the housing crisis, FHA has played a central role in making sure the Nation has a functioning mortgage market when the private market failed. It has served the role it was intended to play.

Today's FHA insures around 20 percent of all mortgages being originated, and almost 40 percent of all new home purchases. The pivotal role that FHA is currently playing in the fragile housing market is important to keep in mind as the threat of Government shutdown looms.

The Federal budget provides FHA with the commitment authority that allows the agency to insure loans. If a budget is not passed, FHA will be unable to endorse any new loans, so anyone who is planning to close on a home using FHA insurance will be out of luck. At a time when the housing market remains so fragile, this seems particularly irresponsible.

The debate about the Government's budget is an important one, but we have to get on with the business of making decisions necessary to fund the Federal Government in a responsible manner, and I believe the time has come for a resolution. The consequences are too great for too many Americans and the Nation's economy to refuse to come to an agreement because of political agendas or pressure.

But as we await a resolution to the fiscal year 2011 budget, we have to continue to do our job in exercising oversight over the programs this subcommittee funds.

For several years, this subcommittee has focused on the solvency of FHA's Insurance Fund. FHA has never received an appropriation to support its Insurance Fund, and I'm committed to making sure that it never does. This subcommittee has worked to provide FHA with the resources necessary to hire skilled staff and develop the technology necessary to oversee FHA's growing portfolio.

And I want to applaud the efforts of the Administration under the leadership of Secretary Donovan, as well as former Commissioner Stevens, to bring a renewed focus on managing risk at FHA.

Despite all of the reforms, the overall health of the housing market is critical to the continued stability and improvement of FHA's finances. We find ourselves at a critical moment: We continue to deal with the ramifications of the housing crisis, while trying to establish a better housing finance system for the future. This challenge is similar to that which FHA has focused on over the last few years. It's working to improve its financial position so it can deal with the fallout of past loans. At the same time, the Department is working to improve its future business and financial position by implementing reforms and creating a culture focused on sound risk management.

Through all of this, FHA has worked to balance the need to mitigate risk with serving its mission of providing access to affordable and sustainable home ownership to under-served Americans.

As we look to the future, we have to find the appropriate balance between strengthening and protecting the housing finance system from undue risk, while maintaining access for credit-worthy Americans to achieve sustainable home ownership.

PREPARED STATEMENT

So, I look forward, Secretary Donovan, to your statement this morning and to questions.

And I want to thank Senator Collins for her work on this, and turn it over to her for her opening statement.

[The statement follows:]

PREPARED STATEMENT OF SENATOR PATTY MURRAY

This morning we are holding a hearing to get an overview on the Federal Housing Administration (FHA) and discuss the future of housing finance. I want to welcome Secretary Donovan back before the subcommittee to discuss these important issues.

FHA—an institution born out of the Great Depression—has assisted millions of Americans in attaining home ownership.

And in the aftermath of the housing crisis, FHA has played a central role in ensuring that the Nation had a functioning mortgage market when the private market failed. It has served the role it was intended to play.

FHA'S ROLE IN THE MARKET AND CONSEQUENCES OF A SHUTDOWN

Today, FHA insures around 20 percent of all mortgages being originated and almost 40 percent of all new home purchases.

The pivotal role that FHA is currently playing in the fragile housing market is important to keep in mind as the threat of a Government shutdown looms.

The Federal budget provides FHA with the commitment authority that allows the agency to insure loans. If a budget isn't passed, FHA will be unable to endorse any new loans. So anyone who was planning to close on a home using FHA insurance will be out of luck.

At a time when the housing market remains so fragile, this seems particularly irresponsible.

The debate about the Government's budget is an important one. But we must get on with the business of making the decisions necessary to fund the Federal Government in a responsible manner. The time has come for a resolution.

The consequences are too great for too many Americans—and the Nation's economy—to refuse to come to an agreement because of political agendas or pressure.

But as we await a resolution to the fiscal year 2011 budget, we must continue to do our job in exercising oversight over the programs we fund.

OVERSIGHT OF FHA

For several years, this subcommittee has focused on the solvency of FHA's Insurance Fund.

FHA has never received an appropriation to support its Insurance Fund; and I am committed to ensuring that it never does.

Yet in the wake of the housing crisis, FHA has sustained substantial losses. As a result, its capital reserve fund has fallen below the level of 2 percent mandated by the Congress.

While this does not mean that FHA will require taxpayer dollars, it highlights the need for vigilant oversight of the agency's portfolio, which has increased dramatically in the last few years.

In recognition of this task, this subcommittee has worked to provide FHA with the resources necessary to hire skilled staff and develop the technology necessary to oversee FHA's growing portfolio.

I want to applaud the efforts of the Administration, under the leadership of Secretary Donovan, as well as Former Commissioner Stevens, to bring a renewed focus on managing risk at FHA.

The Administration has moved quickly to institute significant and necessary reforms to the program.

Among other reforms, FHA has:

—Increased premiums to shore up its finances;
—Set minimum FICO scores;
—Increased down payment requirements for riskier borrowers; and
—Stepped up enforcement so that lenders who aren't following the rules can no longer participate in the program.

In October of 2009, FHA also hired Bob Ryan as the agency's first Chief Risk Officer. The Administration recently announced that Mr. Ryan will serve as acting FHA Commissioner, and I am pleased that this role is being filled by someone who will continue to focus the agency on managing and mitigating risk.

HOUSING MARKET

Despite all of these reforms, the overall health of the housing market is critical to the continued stability and improvement of FHA's finances.

Improving jobs numbers and fewer new delinquencies are positive signs in the market.

But the reality is that:

—Millions of Americans are still in foreclosure and 30 percent of all homeowners have not made a payment over the past 2 years;

—Roughly 7 million borrowers are seriously delinquent and at risk of foreclosure;

—New and existing home sales continue to fall;

—And home prices are declining in most markets—leaving nearly 27 percent of all mortgages in a negative or near-negative equity position

We have a long way to go before the market fully recovers. And it is critical that we continue to look for ways to address the needs of millions of Americans facing the prospect of foreclosure or who are underwater on their mortgage.

We must work to increase opportunities for:

—meaningful modifications;

—achieving a fair and efficient foreclosure process; or

—reasonable options for borrowers trying exit home ownership.

I hope that there will be a global deal that will provide a way to work through the current inventory of delinquent or foreclosed homes that will also provide real relief to borrowers that have been wronged in the process.

THE HOUSING MARKET AND GOVERNMENT-SPONSORED ENTERPRISE REFORM

The market also needs certainty about the new reforms and the future of the Nation's housing finance system.

As we think about the future, we should draw on the important lessons from the recent boom and bust.

This boom was fueled by overconfidence of lenders and investors in the perpetual appreciation of home prices, coupled with inadequate regulatory oversight.

As a result, millions of Americans have lost their homes, and millions more who didn't participate directly in the market run-up have nonetheless seen their wealth eroded as home values declined.

The Dodd-Frank Wall Street Reform and Consumer Protection Act began to address many of the failures of our system and its outdated regulatory structure.

But it is clear that we must also address Fannie Mae and Freddie Mac so we no longer promote a system of private profit and public loss.

However, reform must be approached thoughtfully, so that we don't undermine the fragile housing recovery.

And in our effort to guard against another crash, we must be careful not to overcorrect and put home ownership out of reach for millions of Americans.

As a first step, FHA released its report to the Congress on options for reforming the Nation's housing finance structure.

This report presents three options that range from one with the Government's role limited to FHA, to one where the Government has a more significant presence in the market, though substantially reduced from the role it is playing today.

Each of these options presents tradeoffs that we must consider—tradeoffs between the level of appropriate risk for the taxpayer and the ability of individuals and families to obtain a mortgage.

RISK RETENTION AND QUALIFIED RESIDENTIAL MORTGAGE

A similar debate is also occurring around the rule on risk retention recently proposed by FHA. This rule also includes the definition of a qualified residential mortgage (QRM), which will be exempt from risk-retention requirements.

This rule ensures that lenders have an incentive to properly underwrite loans by requiring them to retain partial exposure to their performance.

Under the proposed QRM definition, loans with a downpayment of 20 percent or more would be exempt from this retention requirement.

Ensuring that borrowers have more equity at stake in their home is an important goal.

At the same time, many hardworking, creditworthy Americans will have a difficult time coming up with a 20-percent downpayment—particularly in high-cost areas, like Puget Sound.

So, I want to have a discussion today about the potential impact of this rule on the availability and affordability of mortgages in the future. Especially as we contemplate the role that FHA or other Government-supported institutions will play in the future.

CLOSING

We find ourselves at a critical moment—we continue to deal with the ramifications of the housing crisis while trying to establish a better housing finance system for the future.

This challenge is similar to that which FHA has faced over the last few years. It is working to improve its financial position so it can deal with the fallout of past loans.

At the same time, the Department is working to improve its future business and financial position by implementing reforms and creating a culture focused on sound risk management.

Through all of this, FHA has worked to balance the need to mitigate risk with serving its mission of providing access to affordable and sustainable home ownership to underserved Americans.

As we look toward the future, we must find the appropriate balance between strengthening and protecting the housing finance system from undue risk, while maintaining access for creditworthy Americans to achieve sustainable home ownership.

I look forward to hearing from Secretary Donovan on these issues. And with that I turn it over to my partner in these efforts, Senator Collins for her opening statement.

OPENING STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you very much, Madam Chairman. Like you, I will submit my opening statement for the record and just make a few very brief comments.

First of all, I wholeheartedly agree with your comments on the need for the Congress to resolve the budget crisis. It is the height of irresponsibility if Government is allowed to shut down, and would represent a colossal failure that would reflect poorly on everyone involved.

And you're right about the impact on the housing market. The Secretary and I were talking prior to the hearing about the critical role that FHA is playing, and the fact that those pending mortgages would come to a screeching halt, and potential homeowners would not be able to close on their properties.

The Department of Housing and Urban Development (HUD) faces many challenging responsibilities that include balancing the goal of strengthening responsible home ownership, while minimizing the financial risk to FHA and the taxpayer, and promoting long-term stability and motivating the private sector to reinvest in the housing market.

Today in my questions I'm going to talk about my concern about HUD's oversight of FHA's Single Family Housing program. I do appreciate and recognize the progress that's been made in minimizing risk to this program, including the creation of a Chief Risk Officer position in 2009. But there, it is clear from a recent USA Today report that FHA has been slow to flag problem lenders and stop them, despite the withdrawal of approval from more than 1,500 approved lenders in the last fiscal year.

The housing market is still very weak, and FHA is going to continue to play a critical role.

PREPARED STATEMENT

Another issue that I want to explore today if we have time is what the impact on FHA will be if we dramatically change the role of the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae). So, those are some of the issues I want to touch on. Again, I'll put my full statement in the record, with your consent. Thank you, Madam Chairman.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SUSAN COLLINS

Chairman Murray, thank you for holding this important hearing to review the Federal Housing Administration (FHA) and to discuss the future of the housing finance market. It is a pleasure to see Secretary Donovan before our subcommittee again, and I join you in welcoming him to this hearing.

The Department of Housing and Urban Development (HUD) faces many challenging responsibilities that include balancing the goal of strengthening responsible home ownership while minimizing the financial risk to FHA and the taxpayer and promoting long-term stability and motivating the private sector to reinvest in the housing market.

FHA is largely financed by proceeds from the mortgage insurance premiums paid by homeowners. As we all know, home purchases provide an important economic stimulus, with benefits to local communities in the form of jobs and local development.

Part of our discussion today will include the status of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which were originally established by the Congress to promote liquidity, affordability, and stability in the housing finance market. The future of FHA heavily relies upon the debate on how to reform Fannie Mae and Freddie Mac. This will be a critical discussion that will shape not only FHA, but also the future of the Nation's housing market.

Recent news articles have highlighted the lack of recovery in most housing markets. Last week, according to Standard & Poor's (S&P) Case-Shiller home price index, U.S. home prices in major cities across the Nation dropped 3.1 percent since January 2010. According to the chairman of the S&P Index Committee, "The housing market recession is not yet over, and none of the statistics are indicating any form of sustained recovery."

These data are particularly concerning since FHA currently insures nearly $1 trillion in mortgages for the single-family home program. The agency's role has dramatically expanded since the beginning of the housing crisis. At the peak of the crisis, FHA accounted for less than 4 percent of the single-family housing market; now it holds more than 20 percent.

Another important issue relates to HUD's oversight of the FHA Single Family Housing program. I recognize and appreciate that HUD has made progress in minimizing risk to this program, including the creation of a Chief Risk Officer position in 2009. A number of reforms have also been implemented to the mortgage insurance premium structure and eligibility requirements to help ensure the long-term economic viability of this program. For example, FHA withdrew approval from more than 1,500 FHA-approved lenders and imposed more than $4 million in civil penalties on noncompliant lenders in fiscal year 2010.

While progress has been made, more needs to be done. Just last month, HUD's Office of Inspector General reported underwriting issues concerning FHA-insured loans. After reviewing 284 loans from 15 lenders, the inspector general found nearly 50 percent of the loans were not underwritten in accordance to FHA requirements. As a result, HUD missed critical opportunities to recover losses of more than $11 million.

It is also troubling that FHA cannot meet its statutory requirement of maintaining a 2-percent capital reserve ratio. According to HUD's own data, the earliest FHA can reach this requirement is 2014. This is a major concern since the reserve ratio was intended to cover unexpected losses.

I am eager to hear the administration's overall plan for revitalizing the financing of the housing market and for the future of FHA, Fannie Mae, and Freddie Mac. We must ensure that we limit taxpayers' exposure to additional financial losses in the housing market.

Chairman Murray, I look forward to working with you and Secretary Donovan on ways to enhance and protect homeowners and to stabilize the housing market by reinvigorating the investments and participation of the private sector. These are not easy issues to resolve, but they are critically important to our Nation's long-term economic health.

Senator MURRAY. Thank you very much. Both of our opening statements will be printed in the record.

And with that, we'll turn it over to Secretary Donovan for opening remarks.

SUMMARY STATEMENT OF HON. SHAUN DONOVAN

Secretary DONOVAN. Thanks, Madam Chair. Thank you, Ranking Member Collins.

And I want to just echo your concerns about the potential impact of a shutdown and the critical importance of resolving this. The President yesterday in remarks talked about the importance of FHA to the broader housing market, to individual Americans on the verge of closing a purchase of a home, or selling a home, and the critical role we play in the housing market today, and the potential significant risks that it would pose if we can't resolve this budget issue.

And he talked about the fact that we have come a great distance. We have agreed to the original cuts that were asked for, proposed by Speaker Boehner, and that, really, what we are down to is politics in this debate. And we must resolve this in order to ensure that we can continue to do the people's business.

In the interest of time, I will also submit my statement. I do just want to make a few comments beyond the concern about the potential shutdown—in particular, to thank you both, and your colleagues in the Congress for your leadership. Thanks to the partnership that we have had with this subcommittee and with the Congress, we have been able to put in place the most sweeping combination of reforms to credit policy, risk management, lender enforcement and consumer protection in the agency's history. And thanks to those, FHA is in a stronger financial position today.

In the last year, we've taken 10 times more lender enforcement actions than FHA had taken in the previous 10 years combined. The agency has implemented a two-step credit score policy that requires borrowers with credit scores below 580 to contribute a minimum down payment of 10 percent. And with your help, FHA has increased premiums to bring back private capital, begin putting into place the cutting-edge modern financial services—IT environment—that FHA needs for the 21st century, and taken steps to increase staffing, which the fiscal year 2012 budget would further.

And I would note that it's our hope that the kind of flexibility that we've proposed for the Government National Mortgage Association (Ginnie Mae) in this budget—to use fees paid by Ginnie Mae's customers to address critical staffing in emerging issues, without requiring any additional congressional appropriations—could be a possible template for addressing critical FHA issues in the years to come.

While we still need the Congress to pass FHA reform legislation that allows us to be prepared for any future crisis, the reforms we've already implemented have resulted in the fiscal year 2010 book of business being the highest quality on record. The average credit score of FHA borrowers has risen to 700. Total reserves have increased. And while foreclosure processing delays are certainly a factor, claim payments are much lower than projected by the independent actuary. As a result, in fiscal year 2012 we expect FHA and Ginnie Mae to generate more than $6 billion in receipts that will offset the Department's gross budget authority request of $47.8 billion and help to rebuild FHA's capital reserves—this in addition to the $9.8 billion in receipts FHA is projected to generate in fiscal year 2011.

Indeed, Madam Chair, even with the decreased loan volume we've seen in recent months, we expect FHA to make substantially more money for the taxpayer this year than our actuary predicted and an even larger amount more than the Congressional Budget Office (CBO) predicted when they did their projections last year. And I'm very pleased to note, thanks to our work with CBO, that our offsetting budget receipts in fiscal year 2012, our estimates of those, are dramatically closer than they have been in years past.

PREPARED STATEMENT

With that, let me stop, and make sure that we can get to your questions. Again, I thank you for the partnership that we've had in working together to make sure that FHA has the resources and the tools that it needs to fulfill its mission. Thank you.

[The statement follows:]

Prepared Statement of Hon. Shaun Donovan

INTRODUCTION

Chairman Murray, Ranking Member Collins, and members of the subcommittee, thank you for the opportunity to testify today regarding the Federal Housing Administration (FHA), in the context of the Department of Housing and Urban Development's (HUD) proposed fiscal year 2012 budget, and also with respect to FHA's key role in the Obama administration's efforts to both address the foreclosure crisis and to reform America's housing finance market.

I was pleased to have the opportunity to testify before this subcommittee on March 6, 2011 to discuss in detail the Department's 2012 budget, Creating Strong, Sustainable, Inclusive Communities and Quality Affordable Homes. As you know, the budget proposal works to "win the future", and I look forward to discussing with you in my testimony how FHA will play a central role in that effort.

I would be remiss if I didn't say a few words about David Stevens, the recently departed FHA Commissioner. Dave brought to the job a unique blend of private sector expertise and commitment to providing underserved communities access to our programs. The strong team that Dave and I were able to put in place was instrumental to ensuring that, in the midst of the worst economic crisis in decades, FHA was able to fill the gap left by the retreat of private capital, while also significantly strengthening FHA's financial position and toughening enforcement. I am delighted that Robert Ryan, our Deputy Assistant Secretary for Risk Management and Regulatory Affairs, will be serving as Acting Assistant Secretary for Housing and FHA Commissioner. While I anticipate the naming of a permanent Commissioner in the near future, I would like to assure the subcommittee that under Bob Ryan's leadership, there will be continuity in FHA's operations, based on the strong foundation laid down by Dave Stevens, including the bipartisan approach he consistently followed.

OVERVIEW OF HUD'S FISCAL YEAR 2012 BUDGET

As I discussed when I last appeared before the subcommittee, we are in an economic environment that is significantly improved from when the President took office. An economy that was shrinking is growing again—and instead of rapid job loss, more than 1.8 million private sector jobs were created in the last 13 months, including 230,000 private sector jobs in March. But we know there's still more work to be done to ensure that America and its workers can compete and win in the 21st century. And we have to take responsibility for our deficit, by investing in what makes America stronger and cutting what does not, and in some cases making reductions in programs that have been successful.

HUD's fiscal year 2012 budget tackles these challenges head on:

—by helping responsible families at risk of losing their homes and by providing quality affordable rental housing;

—by transforming neighborhoods of poverty to ensure we are not leaving a whole generation of our children behind in our poorest communities;

—by rebuilding the national resource that is our federally assisted public housing stock and ensuring that its tenants are part of the mobile, skilled workforce our new global economy requires; and

—by leveraging private sector investments in communities to create jobs and generate the economic growth we need to out-innovate, out-educate, and out-build the rest of the world.

As a downpayment toward reducing the deficit, the President has proposed a freeze on nonsecurity discretionary spending for the next 5 years, cutting the deficit by $400 billion over 10 years and bringing this spending to the lowest share of the economy since President Eisenhower. HUD's fiscal year 2012 budget more than meets the President's goal—the Department's net budget authority of $41.7 billion is 2.8 percent below the fiscal year 2010 actual level of $42.9 billion. To maintain this commitment to fiscal discipline, we have protected existing residents and made the difficult choice to reduce funding for new units and projects, including cuts to the Community Development Block Grant, HOME Investment Partnerships, and new construction components of the Supportive Housing Programs for the Elderly (section 202) and Disabled (section 811).

As discussed in more detail below, this budget balances the need for FHA and the Government National Mortgage Association (Ginnie Mae) to continue supporting the housing recovery in the year ahead and ensuring that underserved borrowers have access to home ownership, with affirmative steps to encourage the return of private capital to the housing market. I want to thank the members of the subcommittee for working with your colleagues to enact legislation (H.R. 5981) in the last Congress to reform FHA's mortgage insurance premium structure. With this authority, FHA announced a premium increase of 25 basis points last month. Because of these reforms and others, the current President's budget reflects estimated FHA offsetting budgetary receipts of $9.8 billion in fiscal year 2011, which will reduce the Federal deficit. This is far more than the $5.8 billion originally estimated by the administration for the current fiscal year. These changes are largely due to the premium increase and the policy changes we have made since the President's budget was published last February. While the ultimate receipts for fiscal year 2011 are subject to fluctuations in loan volume, FHA is on track to outpace both of these figures in the current fiscal year. Furthermore, in fiscal year 2012, the President's budget projects FHA and Ginnie Mae to generate, collectively, more than $6 billion in receipts that will help to rebuild FHA's capital reserves and offset the Department's gross budget authority request of $47.8 billion.

I am pleased to note that, as the members of the subcommittee are no doubt aware, the Congressional Budget Office (CBO) estimate of these offsetting budgetary receipts in fiscal year 2012 are quite close to those reflected in the President's budget—the magnitude of difference between CBO's estimate and the President's budget for fiscal year 2012 is significantly smaller than in previous years at approximately $300 million. I am hopeful this new estimate will make the development of the fiscal year 2012 HUD appropriations bill—a challenging task in any year, and particularly so in the current fiscal climate—somewhat more manageable. I look forward to working with the members of the subcommittee in that effort.

Last, because winning the future also means reforming Government so it is leaner, more transparent, and ready for the 21st century, we are also continuing to reform the administrative infrastructure that oversees our programs. For example, the Transformation Initiative (TI)—important funding and programmatic flexibility the Congress provided beginning in 2010—is enabling HUD to establish the FHA Transformation project, which will give FHA cutting-edge, modern financial services information technology (IT) systems.

RESPONDING TO THE EVOLVING HOUSING CRISIS

Before describing in detail FHA's 2012 budget and the future of the housing market in which FHA will continue to play a central role, I believe it is important to take a brief look at the response of HUD and the administration as a whole to the housing crisis, both in its early stages and today.

In the face of an economic crisis that experts across the political spectrum predicted could turn into the next Great Depression, the Obama administration had no choice but to step in with a plan to aggressively confront the economic crisis as soon as we took office, including taking steps to stabilize the housing market. The Federal Reserve and the Department of the Treasury helped keep mortgage interest rates at record lows with combined mortgage-backed securities purchases of almost $1.5 trillion. Because low-interest rates only matter if there are mortgages available at those rates, the administration also provided critical support for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage

Corporation (Freddie Mac), while FHA and Ginnie Mae stepped in to play critical countercyclical roles in helping to stem the crisis and enabling a robust refinancing market to emerge.

As reported in the Obama administration's March Housing Scorecard, since April 2009, nearly 13 million homeowners have been able to refinance their mortgages to benefit from lower-interest rates, saving them an average of $140 per month or $17.6 billion annually. In addition, the administration proposed, and the Congress enacted, a homebuyer tax credit to spur demand in the devastated housing sector. We also took significant steps to help families keep their homes—through mortgage modifications and FHA's loss mitigation efforts.

The results of these extraordinary actions are clear. Since April 2009, more than 4.4 million borrowers have received restructured mortgages, including more than 1.5 million Home Affordable Modification Program (HAMP) trial modification starts, more than 775,000 FHA loss mitigation and early delinquency interventions, and more than 2.1 million proprietary modifications under HOPE Now—more than twice the number of foreclosures completed in that time. Today, monthly foreclosure starts are down more than 30,000 per month from this same time 1 year ago. I would note that while the sharp decline may be partially attributed to servicer process reviews in light of foreclosure processing deficiencies, the number of homeowners entering delinquency in the first place was down significantly even before these reviews began. That said, this number may trend upwards as servicers revise and resubmit foreclosure paperwork in coming months,

Additionally, FHA and HUD recently launched two programs to address the two most pressing problems facing the housing market, negative equity and unemployment.

—In September 2010, FHA launched the FHA Short Refinance Option to assist non-FHA borrowers to refinance their underwater mortgages into sustainable fixed rate, FHA-insured mortgages. This option provides an additional opportunity for lenders to voluntarily offer principal writedowns and restructure loans for some families who owe more than their home is worth. To date, more than 400 applications have been submitted by a wide diversity of lenders and four large servicers have announced that they are finalizing development of the infrastructure that is required to participate in this program and voluntarily offer principal writedowns to select underwater borrowers, which will benefit homeowners by reducing their monthly payments and addressing negative equity, while also significantly reducing the investors' risk of default.

—As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Congress provided HUD authority and funds to assist unemployed and underemployed homeowners struggling to make their mortgage payments via the Emergency Homeowner Loan Program (EHLP). Last week, HUD announced that five States—Connecticut, Delaware, Idaho, Maryland, and Pennsylvania—have been approved to provide a combined total of almost $200 million of assistance from these funds. These States are expected to be ready to accept applications as soon as next week to help eligible residents in these States. HUD continues to responsibly develop additional components of the program to serve the remaining 27 States that have been awarded EHLP funds, and we will announce additional details and program specifics for these States in the coming weeks.

FHA'S FISCAL YEAR 2012 BUDGET

The number of borrowers who depend on FHA for access to mortgage financing has increased greatly during this economic recovery as access to private capital has contracted in the recent difficult economic period. In fiscal year 2012, HUD is requesting $400 billion in loan guarantee authority for the Mutual Mortgage Insurance Fund, which will provide an estimated 1.2 million single-family mortgages. In addition, HUD is requesting $25 billion in loan guarantee authority for the General and Special Risk Insurance Fund, which will enable FHA to insure an estimated 190,000 units in multifamily housing properties and an estimated 98,000 beds in healthcare facilities.

As housing markets continue to be stressed, FHA is taking on business that is resulting in a portfolio of historically high borrower credit quality. These new loan guarantees and mortgage insurance premiums that they generate are providing net income that can be used both to offset claim expenses on the earlier books and to start rebuilding FHA's capital position.

FHA Multifamily Mortgage Insurance

With more than one-third of all American families renting their homes, during this time of economic hardship for so many it is more important than ever to provide a sufficient supply of affordable rental homes for low-income families. Multifamily mortgage insurance programs make critical contributions toward the Department's mission of creating strong, sustainable, inclusive communities and quality affordable homes for all by expanding the supply of rental housing in areas where they are most needed, and by preserving the affordability and quality of both federally assisted and private unassisted rental housing. The role of FHA's multifamily mortgage insurance programs is especially significant in the current economic climate. Driven by low-interest rates, more constrained lending in the conventional mortgage market, and improvements in HUD business operations, demand for FHA multifamily programs has increased dramatically. At this time of unprecedented stress in the financial markets, FHA multifamily programs provide necessary liquidity so that apartment construction and rehabilitation can continue. FHA financing is often paired with low-income housing tax credits, rental subsidies for low- and moderate-income families, tax-exempt bond financing, and/or other State and local resources to expand the offering of affordable units in areas where they are needed most. Multifamily mortgage insurance programs also contribute significantly to local revitalization efforts and economies by providing liquidity to uniquely sustainable projects located in centers of job growth, near transportation and other community opportunities.

In 2008, FHA supported the development of about 49,000 rental homes. Now, however, conditions are very different, reflecting the sharp decline in fully private financing and most notably commercial mortgage-backed securities. In 2010 alone, FHA supported the development or refinancing of more than 150,000 rental units with a total dollar volume of nearly $11 billion—almost four times the level of 2 years earlier, and now almost 25 percent of the multifamily market. This activity is projected to increase further to $13.1 billion in 2011 and to be at a level of $12.8 billion in 2012. HUD estimates that these construction volumes will support up to 85,000 direct jobs annually.

I'd like to thank the Congress for passing legislation last summer—H.R. 5872, the General and Special Risk Insurance Funds Availability Act of 2010—to increase FHA's commitment authority for our multifamily and healthcare facilities insurance programs. This was a key step to help facilitate the continued production and refinancing of multifamily properties and healthcare facilities. To ensure that these programs continue to operate responsibly despite the unprecedented demand, FHA simultaneously implemented the most significant reforms to its multifamily programs to strengthen underwriting guidelines and minimize financial risk to taxpayers while providing this critical support.

FHA-Insured Healthcare Facilities

In fiscal year 2011, FHA is continuing to provide critical support to enable the construction and refinancing of acute-care hospitals, skilled nursing, assisted living, and board and care facilities. Additionally, these projects contribute to stimulating the local community economy where the project is based as well, expanding employment, and reducing healthcare capital costs. In fiscal year 2010, 17 hospital facilities received commitments to advance their mission in communities throughout the country. For fiscal year 2010, the total construction expenditures for all hospital commitments amounted to $1.4 billion, which HUD estimates will result in 15,465 new direct jobs that will be created during construction, with $3.9 billion of overall economic benefit. Following construction, fiscal year 2010 projects will generate estimated annual new economic activity of $1.4 billion and 8,464 new jobs.

Demand for section 232 Residential Care Facilities (Skilled Nursing, Assisted Living, and Board and Care Facilities) has also increased. FHA considered 347 applications and issued commitments for 318 facilities in fiscal year 2010. As of March 18, 2011, an additional 241 insurance commitments have already been issued in fiscal year 2011 for 232 program applicants serving the senior housing market. Through LEAN processing methods and high productivity from FHA staff members, this industry-generated volume is being addressed as responsibly as possible given staffing and capacity constraints.

Home Equity Conversion Mortgages

In October, FHA launched the Home Equity Conversion Mortgages (HECM) Saver product. Designed as a second reverse mortgage option for senior home owners to tap into their equity, the HECM Saver product has lower upfront loan closing costs and is optimal for homeowners who want to borrow a smaller amount than that which would be available with a HECM Standard loan.

HECM Saver has a nominal upfront premium of only 0.01 percent of the property's value. Under the HECM Standard option, the upfront premium remains at 2 percent. The mortgage insurance premium for both HECM Saver and HECM

Standard is charged monthly at an annual rate of 1.25 percent of the outstanding loan balance. The 2012 President's budget request estimates that these two programs will generate $304 million in receipts.

Borrowers using the Saver option have access to home equity in amounts that are between 10–18 percent less than would be available with the HECM Standard option. The reduction equity take-out for Saver substantially lowers risk to the FHA Insurance Fund, and thus permits the virtual elimination of the upfront premium charge.

HECM Standard remains as an option for senior home owners who need to tap the highest-possible home equity to cover living expenses and/or healthcare costs, while continuing to live in their homes without having to make the mortgage payments required with a traditional mortgage or home equity loan.

Transformation Initiative

Winning the future means reforming Government so it's leaner, transparent, and ready for the 21st century. While HUD programs already make a significant difference in the lives of ordinary Americans, this administration is also committed to making Government more efficient, more effective, and more accountable. The fiscal year 2012 budget provides up to $120 million for the TI Fund to support cutting edge research and demonstrations and technical assistance to our partners. In fiscal year 2010, thanks to the TI Fund, HUD began to fundamentally alter how we approached our investments in delivering technical and capacity-building assistance, conducting research demonstrations, and maintaining and upgrading our IT systems so that we can hold ourselves and our local partners accountable for the outcomes needed to achieve the Department's strategic goals.

Twenty-First-Century Technology To Protect the Taxpayer's Investment

In fiscal years 2010 and 2011, IT investments constituted the largest share of proposed TI project funding, $122.5 million was allocated for IT in fiscal year 2010 and $119 million was requested in fiscal year 2011. The Department's careful investment planning has prepared us to act responsibly to modernize our use of IT to meet today's mission challenges. Our intent is to fully leverage these resources to meet our transformation needs. Additional funding was not requested in fiscal year 2012 on the presumption that sufficient funding would be available to support these projects for fiscal year 2012, between prior-year TI funding and the Working Capital Fund.

One of the top-priority IT projects is the FHA Transformation project, which involves the development of a modern financial services IT environment to better manage and mitigate counterparty risk across all of FHA's insurance programs. The new tools will minimize the exposure of our insurance funds and support the restoration of the capital reserve ratio to congressionally mandated levels by enabling risk detection, fraud prevention and the capture of critical data points at the front-end of the loan life cycle. More simply put, FHA Transformation will enable HUD to identify trends, and seamlessly take action, before problems occur. This approach will protect consumers and the economy by ensuring that lenders adhere to safe underwriting standards. Importantly, FHA Transformation will also allow HUD to start the careful process of migrating relevant portions of our legacy applications, most of which were built in a 1970s era programming language, to a more cost-effective platform.

In addition to prior-year TI fund transfers, in fiscal year 2012 HUD will utilize $315 million in Working Capital funding to support HUD's transformation efforts, providing resources for the development of, modification to, and infrastructure for department-wide information technology systems.

Housing Counseling Assistance

Each year, HUD awards grants to hundreds of local counseling agencies and State Housing Finance Agencies that offer a variety of services, which are especially critical in today's economic climate. HUD-approved counselors help clients learn how to avoid foreclosure, how to purchase or rent a home, how to improve credit scores, and how to qualify for a reverse mortgage. In 2009, HUD assisted more than 2.5 million families through its housing counseling program, including 1.58 million potential and current homeowners with issues pertaining to mortgages and financing of their homes. In 2010, HUD awarded $79 million for housing counseling grants, a 27-percent increase over its 2009 funding.

In fiscal year 2012, HUD is requesting $88 million in Housing Counseling Assistance. The primary benefits of the program are to expand home ownership opportunities, improve access to affordable housing and preserve home ownership. With this level of funding, HUD anticipates serving as many as 318,187 low- to moderate-income families, as well as training approximately 4,400 counselors.

Salaries and Expenses—Flexibility To Respond in a Crisis

As the subcommittee knows, HUD's salaries and expenses budget is divided into multiple sub-accounts, with limited transfer and reprogramming flexibility. While the Department has once again submitted this portion of the budget proposal in that structure, recent FHA and Ginnie Mae staffing needs have illustrated the challenges of proposing a personnel plan a full year and a half prior to the onset of the fiscal year. Events, including developments related to the housing crisis, can intervene and the Department needs the flexibility to respond. Accordingly, I hope that we can work with the subcommittee to strike an appropriate balance between the need for transparency and oversight of HUD's salary and expenses expenditures, and this need to be able to respond nimbly to changing circumstances.

In the fiscal year 2012 budget, we have proposed to restructure the Executive Direction account by removing subfunction allocations to provide the Department with the flexibility needed to respond promptly to emerging issues or unanticipated needs as they arise throughout the year. Moreover, we would like to explore with your subcommittee, the possibility of providing additional administrative flexibilities in accounts funding salaries and expenses across the Department. Over the past 2 years, it has become clear to us that the administrative burden and lack of flexibility afforded by the current structure outweighs the potential management benefits.

Ginnie Mae Budget Request for Salaries and Expenses as a Model

Our budget request with respect to Ginnie Mae's staffing needs, provides an example of the kind of flexibility that can be achieved to enable greater capacity, service, and protection to taxpayers, without requiring additional appropriations. In light of Ginnie Mae's vastly increased market share (from 4 percent to more than 30 percent in the past few years) and a guaranty portfolio that now tops $1 trillion, the fiscal year 2012 request proposes to fund its personnel expenses through commitment and multiclass fees rather than through a separate appropriation for personnel compensation and benefits. This will allow Ginnie Mae to increase its staff level to strengthen risk management and oversight, and to move in-house some functions that are performed by contractors.

Our budget proposal affords Ginnie Mae more flexibility in funding its critical personnel and administrative needs. Importantly, the Congress will retain its role in determining annual Ginnie Mae funding. However, with receipts accumulating in Ginnie Mae's program account, a ready source of funding will be available to help the agency fund both current needs along with contingencies that may arise in the future. In addition, the budget allows Ginnie Mae to increase the amount for salaries and expenses if its volume of guaranty commitments rises above a specified level. The budget proposes to allocate $100 for salaries and expenses for each $1 million of guaranty commitments exceeding $300 billion. As Ginnie Mae's role in the housing finance market continues to grow, it is critical that the agency have this additional flexibility to be able to respond to market needs. This proposal positions Ginnie Mae to continue to effectively and responsibly bring global capital into the American housing finance system.

With respect to FHA, we have requested a significant increase in staffing in the fiscal year 2012 budget—92 additional FTEs compared to fiscal year 2010 enacted levels.

REVIEW OF FHA'S FINANCIAL CONDITION

Results From FHA Reforms to Date

As you know from the Secretary's Annual Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance (MMI) Fund at the end of fiscal year 2009, the secondary reserves held in FHA's Capital Reserve account to support single-family loan guarantees had fallen below the required 2-percent level—to 0.53 percent of the total insurance in-force. At the same time, total reserves held in the Capital and the Financing accounts at that time were at an historical high of more than $31 billion. Total reserves grew again to more than $33 billion in fiscal year 2010. These funds are available to cover potential future losses on outstanding loan guarantees. The independent actuarial study for fiscal year 2010 indicated that these would be sufficient for even a stressed scenario of loan performance over the next 5 years. Even prior to the release of the fiscal year 2009 actuarial review that indicated capital reserves had fallen below the statutory threshold, we took several steps to strengthen the fund. Today, I am pleased to inform you that tangible, measurable progress has been achieved and we continue to see improvements in the financial condition of the fund, while holding lenders more accountable, and reducing risk to taxpayers.

Making that progress required FHA to put in place the most sweeping combination of reforms to credit policy, risk management, lender enforcement, and consumer protection in the agency's history. These reforms have strengthened its financial condition and minimized risk to taxpayers, while allowing FHA to continue fulfilling our mission of providing responsible access to home ownership for first-time homebuyers and in underserved markets.

Specifically, FHA implemented a two-step credit score policy for FHA borrowers. Those with credit scores below 580 are now required to contribute a minimum downpayment of 10 percent, or have equity of 10 percent at the time of refinance. Only those with stronger credit scores are eligible for FHA-insured mortgages with the minimum 3.5 percent downpayment.

To balance the need to provide access to our mortgage markets with the need to protect taxpayers from financial risk, we established FHA's first Office of Risk Management. With this new office and additional staffing, FHA is expanding its capacity to assess financial and operational risk, perform more sophisticated data analysis, and respond to market developments.

Further, FHA has strengthened credit and risk controls—toughening requirements on FHA's Streamlined Refinance program, making several improvements to the appraisal process and to condominium policies, and implementing the two-step credit score policy discussed above. We are very grateful for the support that the Congress has provided to our efforts to reduce fraud and risk. Through the $20 million Combating Mortgage Fraud funds that the Congress granted HUD in fiscal year 2010, we have begun to implement several risk management and systems modernization reforms to incorporate modern risk and fraud tools and counterparty data consolidation. Additionally, FHA introduced policy changes and improved lender oversight and enforcement to increase the quality of FHA-insured loans.

As a result of these actions, FHA finds itself in a stronger position today. In particular:

—The quality of loans endorsed in 2009 and 2010—the years FHA has done the most significant volume—is much improved. Fiscal year 2010 is the highest quality FHA book-of-business on record, and fiscal year 2011 may prove to be even better.

—The credit-score distribution for new insurance continues to improve. The average credit score on current insurance endorsements has risen to 700. And in the second-half of calendar year 2010, average credit scores were equally strong across refinance and purchase books-of-business.

—Loan performance, as measured by early period delinquency and by seasonally adjusted serious delinquency rates, continues to show significant improvement from the high rates experienced in 2007 and 2008.[1]

—FHA's seasonally adjusted 90+ day delinquency rate in December 2010 was 5.8 percent, compared to 7.45 percent in December 2009.

Summary of Fiscal Year 2010 Actuarial Review

Total capital resources (combined Capital Reserve account and Financing account) in fiscal year 2010 increased by $1.5 billion to $33.3 billion. At the same time, the overall capital ratio held steady at 0.5 percent reflecting that more conservative economic forecasts and model changes offset the benefits of improved borrower credit profiles and increased premium income. On a stand-alone basis, had capital resources not been shifted from the forward loan accounts to HECM accounts to cover HECM budget re-estimates, the capital ratio of single-family forward loans (96 percent of the portfolio) would have increased from 0.42 percent in fiscal year 2009 to 0.79 percent in fiscal year 2010, demonstrating significant improvement in loan quality and underlying reserves. Without any additional policy actions, and incorporating conservative economic forecasts, the capital ratio for the entire MMI Fund is projected by the independent actuaries to exceed the 2-percent statutory requirement early in 2015. Furthermore, we have implemented a wide range of additional policy actions that are expected to strengthen the fund even more quickly than forecasted.

While we are not yet completely out of the woods based on the evidence we're seeing, FHA is weathering the economic storm. And we're doing so, Madam Chairwoman, while simultaneously reducing financial risk to taxpayers and helping to create a firm foundation for the recovery of the housing finance system.

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[1] HUD's Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund fiscal year 2010 can be found at http://www.hud.gov/offices/hsg/rmra/oe/rpts/actr/2010actr__subltr.pdf.

The Need for FHA Reform Legislation

As discussed, within the existing authorities granted to us by the Congress, we have already begun the necessary process of making changes to FHA to ensure that it will be able continue its mission. Moving forward, we look to the Congress to pass FHA reform legislation that enhances our lender enforcement capabilities and risk management efforts that are critical to our ability to monitor lender performance and ensure compliance, among other things. Indeed, last year the House of Representatives passed an FHA reform bill, H.R. 5072, containing an array of changes along these lines, and, while similar legislation was introduced in the Senate, action on the bill was not completed. I urge the Congress to make passage of legislation along these lines a top priority in the 112th Congress. In addition to provisions strengthening FHA's lender enforcement ability, the 111th Congress bill also included technical clarifications that will allow third-party loan originators to close FHA-insured loans in their name. This third-party originator provision is particularly important to ensuring that several hundred community banks are able to continue originating FHA loans. Additionally, HUD is seeking congressional authority to extend FHA's ability to hold all lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated and for which the error may have impacted the original loan decision, or in which fraud or misrepresentation were involved. We also hope to work with the Congress to give FHA additional flexibility to respond to stress in the housing market and to manage its risk more effectively. This will mean giving FHA flexibility to adjust fees and programmatic parameters more nimbly than it can today. FHA should also have the technology and talent needed to run a world-class financial institution.

THE FUTURE OF HOUSING FINANCE

Toward a New System of Housing Finance

Despite all of the efforts to date, there is much more to do. We must continue to take steps to facilitate the return of private capital to the housing finance system in a responsible way. Last summer, the Congress passed, and the President signed, sweeping financial reform legislation. Crucially, the Dodd-Frank Act provides vital protections for consumers and investors that will help end abusive practices in the mortgage market and improve the stability of the overall housing finance market.

In keeping with our obligations under the Dodd-Frank Act, the Obama administration recently delivered a report to the Congress, Reforming America's Housing Finance Market, which provides a path forward for reforming our Nation's housing finance system. The report outlines steps that will be taken to wind down Fannie Mae and Freddie Mac and help bring private capital back to the market in a first loss position. Moreover, it describes how to fix fundamental flaws in the mortgage markets and better target the Government's support for a full range of housing that is affordable for its occupants, and lays out choices for longer-term reforms.

Bringing private capital back into the housing finance system does not mean eliminating all Government involvement in housing finance. We believe that a Government role, targeted correctly, and with the right protections for taxpayers, should remain an important component of any future system. That is why all three of the reform options we lay out in the white paper include a strong, resilient FHA and solid consumer and investor protections.

To that end, reforming and strengthening FHA is the first of four primary areas of reform to achieve a system with transparent and targeted support for mortgage access and housing affordability. The other crucial components of reform are a commitment to affordable rental housing, a flexible and transparent funding source for access and affordability initiatives, and strong measures to ensure that capital is available to creditworthy borrowers in all communities, including rural areas, economically distressed regions, and low-income communities.

The Importance of a Robust and Responsible Private Mortgage Market

Today, FHA is the largest insurer of mortgages in the world, with a portfolio that today exceeds $1 trillion, and a history that includes insuring more than 39 million home mortgages and 52,000 multifamily project mortgages since 1934.

But a critical component to further recovery of the broader economy, and to reducing the financial risk to taxpayers, is to facilitate the return of private capital to the housing finance system in a responsible way. This was a central goal of the administration's recently released report on Reforming America's Housing Finance Market, which proposed to wind down Fannie Mae and Freddie Mac, fix fundamental flaws in the mortgage markets, make the Government's support for affordable housing explicit and better targeted, and provide choices for longer-term reforms. The return of private capital is particularly important given that today, Fannie Mae, Freddie Mac, FHA, and Ginnie Mae collectively insure or guarantee more than 9 out of every 10 new mortgages.

During the height of the housing boom in 2006, FHA-insured mortgages constituted less than 4 percent of the number of new home purchases. This was a significant decrease from FHA's historically traditional share of approximately 10–15 percent, and an indication that the private sector was aggressively extending credit. All too painfully, we learned that this extension was often irresponsible. As poorly underwritten subprime loans and other products that were securitized into private label securities (PLS) began to default at an alarming rate, their defaults led to losses throughout the private market and private capital vanished from the housing sector at an unprecedented pace—in 2006, more than $1 trillion of such mortgages were securitized into PLS; in 2010, that figure was less than $60 billion.[2]

FHA's temporarily elevated market share of more than 20 percent of the overall loan volume (home purchases and refinances) is the result of our efforts to fulfill our mission to be a countercyclical facilitator of responsible capital liquidity in the housing sector at times when the private sector exits the market abruptly. As the subcommittee knows, FHA does not lend directly to homeowners, but instead insures lenders against losses that may result in the event of a borrower default, under the condition that lenders are required to abide by extensive documentation and underwriting guidelines to originate sustainable mortgages, as well as providing numerous loss mitigation opportunities to help borrowers avoid default or foreclosure.

The most recent data shows that 60 percent of African-American and Latino homebuyers purchase homes with FHA backing.[3] FHA thus plays a vital role in opening up access to home ownership for the underserved in our country.

A Reformed and Strengthened FHA

Strengthening and reforming FHA in a way that is healthy for its long-term finances and ensures that FHA is able to continue its mission of providing access to mortgages for low- and moderate-income families is a central component of broader systematic reforms. While FHA has already changed policy to require that borrowers with lower FICO scores make larger downpayments, FHA will consider other options, such as lowering the maximum loan-to-value ratio for qualifying mortgages more broadly. In considering how to apply such options, FHA will continue to balance the need to manage prudently the risk to FHA and the borrower with its efforts to ensure access to affordable loans for lower- and middle-income Americans, including providing access to home ownership for first-time homebuyers and underserved markets.

FHA will take any steps for reform carefully to ensure that they do not undermine the broader recovery of the housing market. Similarly, as we consider changes in such areas as downpayments and loan-to-value ratios, we will make sure to retain the flexibility to respond to changing market conditions, so that we are able to manage risk, and maintain access, as effectively as possible.

Some have expressed concerns that the increases to the monthly premium set to go into effect next month—on the order of $30 per month for the typical home-purchase borrower—and any increase in downpayment requirements have the potential to excessively restrict access to credit or perpetuate a dual credit market. We believe that the benefit to the financial health of FHA of the relatively modest premium increase is appropriately balanced with the need to maintain access, as the change remains affordable for almost all homebuyers who would qualify for a new loan. Similarly, we will strongly consider the impact on access with any proposal to increase downpayment requirements.

Proposed Rule for Qualified Residential Mortgage

Last month, HUD joined with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Federal Reserve, and the Securities and Exchange Commission to announce the consideration and release of their Notice of Proposed Rulemaking for section 941 of the Dodd-Frank Act, which sets proposed rules to implement the credit risk-retention requirements for asset-backed securities and sets a 60-day comment period where all stakeholders are able to comment and provide feedback. Following this comment period, the rule writers will consider all comments received before releasing final rules.

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[2] Source: Inside Mortgage Finance, HMDA, and Mortgage Bankers Association.
[3] HUD analysis of 2009 Home Mortgage Disclosure Act data.

The goal of the proposed rule is to provide clarity and rules of the road to the securitization markets. The proposed rule is one part of the administration's goal of bringing private capital back into the housing finance system.

Getting this right is critical. With the financial crisis, we saw how bundling and packaging mortgages to sell on Wall Street with no accountability helped lead to the erosion of lending and underwriting standards that fed the housing boom and deepened the housing bust. The Dodd-Frank Act requires that securitizers or originators have "skin in the game" by retaining at least 5 percent of the credit risk and the rule proposed today sets out options to accomplish that mandate.

Importantly, the rule seeks to define qualified residential mortgages—the loans that would not be subject to the risk-retention requirements. Much debate will center on the size of downpayments. While there is no question that larger downpayments correlate with better loan performance, downpayments only tell part of the story. That's why we have laid out two alternatives, one requiring a 10-percent downpayment and another requiring 20 percent.

We look forward to comments from stakeholders on the relative merits of these choices, so that we strike the right balance between managing risk and maintaining access to safe, responsible home ownership.

CONCLUSION

Madam Chairwoman, between our budget request and the Obama administration's proposals to reform the housing finance system, it is clear that FHA will continue to play a central role in the continued recovery of the housing market—particularly its ongoing commitment to provide access and affordability to low- and middle-income Americans. And as the reforms we have already made demonstrate, FHA has the capacity to perform this role in a way that minimizes risk to the taxpayer.

I look forward to working with this subcommittee—and this Congress—to ensure that FHA has the tools it needs to fulfill that mission. Madam Chairwoman, thank you again for this opportunity to testify. I would be glad to respond to any questions.

GOVERNMENT SHUTDOWN

Senator MURRAY. Thank you very much, Mr. Secretary. And we will put your entire statement into the record for all of our members.

We've all been talking about it—obviously, this hearing is about writing the fiscal year 2012 appropriations bill—but we are all very concerned about finishing the fiscal year 2011 budget, and the concern about the prospects of a Government shutdown. There are a lot of consequences, obviously. You mentioned a few.

But I wanted to ask you specifically today—particularly for Americans hoping to buy a home with FHA insurance, what are the consequences if Government shuts down?

Secretary DONOVAN. Quite simply, if there is a shutdown, FHA cannot endorse any further loans. Individual lenders would have the ability to continue to fund loans on their own. They would have to draw funding from their own balance sheets to do that, under the hope that they could then come back and insure those once the shutdown was ended.

But unlike in the prior shutdown, when FHA represented a very small fraction of the market, given that we are endorsing close to $30 billion in loans a month, I am very concerned that a significant number of lenders would not choose to continue to close on those loans, and particularly, if there were any extended period that the shutdown continued, that both the costs of funding those loans and the potential risks of defaults or other issues with those loans would increase the pressure on lenders to stop funding loans during that period.

Senator MURRAY. This is going to affect a lot of people. If you're hoping to sell your home because you're buying another one—it could impact you, too, obviously, if you are purchasing a home. Do we have any idea how many homebuyers would be affected by this?

Secretary DONOVAN. The President spoke eloquently yesterday about the impacts on someone on the verge of buying their first home—80 percent of our loans went to first-time homebuyers last year—and also, about the impact on anyone in the process of selling their home—if you're planning to move, to take a new job in a different location. Multiply that by the millions of homeowners that depended on FHA financing last year. We represented 40 percent of all home purchases in this country last year. And so, the impact isn't just on individual families. It's on entire communities, and the international housing market.

So, we do have real concerns, at a time when our market continues to be fragile, when our economy has shown real progress with 1.8 million private sector jobs created over the last 13 months. This is the worst time that we could introduce that uncertainty into this fragile housing market.

Senator MURRAY. For any of us who have been there—known we have to move out by a certain date, and we're waiting for a closing to occur—this is a very, very stressful moment for many families. So, I'm very concerned about that.

We also know that Federal funds support HUD and FHA's efforts to oversee its growing portfolio. That would, of course, be put on hold as well, correct?

Secretary DONOVAN. That's correct.

And I would also add, Madam Chair, that while the focus today is on FHA, we have millions of families who depend on our assistance—whether it's through vouchers, or public housing, or a range of our other programs—more than one-half of the residents of HUD-assisted housing are elderly or disabled. And our ability to provide funds for the operations of those units—the capital to do repairs on those units, and the jobs that that creates in construction, which is an industry that's been particularly hard-hit by the downturn—all of those are put at risk, because we simply can't provide any further funds. And so, while it may be a number of weeks that housing authorities could continue to operate, the lack of payments, particularly if there's an extended shutdown, would be very problematic for those families as well, and put millions of families at risk.

Senator MURRAY. Okay. Thank you very much for outlining it. I think we need to understand what the consequences of this are, and that's been very helpful.

I'm going to turn it over to Senator Collins, and then I have a few additional questions as well.

Senator COLLINS. Thank you, Madam Chairman.

First, let me associate myself with the Chairman's comments. I was thinking, having recently moved, that this affects not only the buyer of the house, the seller, the moving company—the ripple effects go on and on. And that's why we simply must resolve this issue.

Mr. Secretary, I mentioned in my opening statement that I would like you to comment on what the role of FHA would be if Fannie

Mae and Freddie Mac's roles were diminished, or the entities were privatized. Would that have an impact on the role played by FHA?

Secretary DONOVAN. Absolutely. And I think our housing finance reform proposal that we laid out 2 months ago with the Department of the Treasury made clear that, in all cases, we foresee a smaller role for FHA, and a smaller role for Fannie Mae and Freddie Mac going forward; that, simply, we must take steps, as we've begun to do, to shrink the footprint of Government in the housing finance market. And in particular, the proposed increase in premiums that we have in the budget for 2012 is an important step, along with our endorsement of allowing the loan limits to step down on October 1, as they would currently do without further action by the Congress.

So, having said that, in the context of believing that we need to work to reduce the footprint of both the Government-sponsored enterprises (GSEs) and FHA, we lay out a set of options in the white paper, and in particular, if option 1—which would have no additional ability for the Federal Government to provide mortgage insurance outside of FHA—were the path, then I think we would see a significantly increased role of FHA relative to other options. And in particular, in moments of crisis, it would be enormously important that FHA have the flexibility and the ability to step up even more significantly than it has done through this crisis. We've reached, as I said earlier, 40 percent of the purchase market. But in the kind of crisis that we've experienced, without a Fannie Mae or Freddie Mac, it would be absolutely critical that FHA could potentially go even further to ensure that the housing market is not further damaged by the kind of crisis that we've seen.

LOAN LIMITS

Senator COLLINS. At your previous appearance before this subcommittee, you recommended a reduction in the loan limit from $729,750 to $625,000. There are several bankers with whom I've talked who believe that is still far too high if the goal of Government is to try to make housing more accessible to lower- and middle-income families. What is your response to that criticism?

Secretary DONOVAN. The administration believes that we ought to work together with the Congress to design lower limits for FHA beyond the initial step on October 1.

Having said that, it is absolutely critical that we do that in the context of what the housing finance system would look like more broadly. In other words, if we have a well-designed, targeted, explicit guarantee that would be available outside of FHA, I think it would be wise to look at a reduction of those loan limits that would go further than if we did not have an alternative mechanism for guaranteeing loans, either in a crisis or during more normal times in the market. Because, frankly, FHA would be called on, as I just said, to do more without some alternative form of explicit, targeted guarantee.

And so, I think we can't, in the absence of coming to some agreement with the Congress about the broader solutions for the housing finance market, be too specific about what an FHA loan limit would look like, other than to say it should be lower than the $625,000 that we've talked about.

Senator COLLINS. Thank you.
Senator MURRAY. Senator Blunt.

STATEMENT OF SENATOR ROY BLUNT

Senator BLUNT. Thank you, Chairman, just a couple of questions quickly. I know we're on a timeframe here, and I appreciate that.

So, what impact does it have on the housing market when you—this may be in your prepared statement, too, Secretary, I apologize if I've missed this already—if you lower this limit? How does that impact an already fragile housing market? Are you concerned about that?

Secretary DONOVAN. What we have seen, in fact, is that there is a relatively small share of FHA's overall lending, significantly less than 10 percent, that is above that $625,000 limit at this point. So, that initial step——

Senator BLUNT. Significantly lower than what?

Secretary DONOVAN. Than the $625,000 limit which would go into effect—that lower limit that would go into effect on October 1. So, while it has some impact on FHA, the bigger impact would be on lending by Fannie Mae and Freddie Mac. And that would be an important step for us, to see if private capital were to return to that level of lending, and what kind of rates it would be at.

As we just discussed, the much more significant impact would be to begin to look at going back down to significantly lower limits—$417,000 was the limit before. It was raised by the Housing and Economic Reform Act (HERA) up to the $625,000, then to be raised further after that.

Really, what you're looking is more like about 20 to 25 percent of our lending that's between that $417,000 limit and the $625,000 limit. So, that's really where I think we need to have a fuller discussion with the Congress about where we ought to go. And I would particularly mention that this will be important in higher cost markets; a much larger share of our lending in California, in certain metropolitan areas, like Seattle, is at that higher limit. And so, the localized impacts could go significantly higher than that 20 or 25 percent of our business that I talked about.

FHA PREMIUM INCREASE

Senator BLUNT. And in terms of the premiums—I know you're talking about FHA, raising the new premium structure—what's the likelihood that that structure will serve the purpose for the full budget year and beyond, or that you'll have to have another adjustment?

Secretary DONOVAN. First of all, the impact of the 25-basis-point increase is in the range of $30 a month. And given that interest rates remain very low, given that our Ginnie Mae securities, in particular, continue to be very attractive investments, I am not substantially concerned. We do expect some decrease in volume. As I've said, we do expect to see private capital return—mortgage insurers and others—to step up as we increase the premiums. But I don't think that it will have a major effect, and certainly not a significant effect, on the overall national market.

I think it's very hard to say, Senator, today, without knowing the initial impacts that the combination of a change in loan limits and the premium structure—we've also seen Fannie Mae and Freddie Mac increase their pricing structure as well. I would really want to see what the impacts are, where the housing market is, through the critical summer period that we're going to be coming into, before I would say specifically whether we need to continue to increase premiums or not. At this point, given the actuarial review and where we are, I'm confident that this premium increase will help us rebuild the reserves to through 2012. Beyond that, I really would like to come back once we see the initial impact and have a fuller discussion with you.

PREPARED STATEMENT

Senator BLUNT. Okay, Madam Chairman, thank you.
[The statement follows:]

PREPARED STATEMENT OF SENATOR ROY BLUNT

Thank you Chairman Murray and Ranking Member Collins for holding today's hearing. The topics for this hearing are extremely important and in the forefront of many people's minds.

Also, welcome back Secretary Donovan and thank you for appearing before our subcommittee on behalf of the now acting commissioner, Bob Ryan. As we recover from the recent housing crisis, I look forward to serious discussions with you about our current housing finance system.

Since the crisis, Federal Housing Administration (FHA) has become the lender of first resort for both homebuyers and homeowners who want to refinance. FHA alone now guarantees about one-third of all home loans, up from about 3 percent before the financial crisis. Like many, I have grave concerns that with an implicit guarantee from the Federal Government, this agency could be the next big bailout waiting to happen.

FHA was to be self-sustaining and was founded to help low- to moderate-income borrowers achieve home ownership; so it is troubling to see this dramatic increase in lending authority. People with substantial borrowing power should not make up such a substantial portion of the FHA loan portfolio, and I am interested in hearing how you plan to address this unsustainable growth.

Last year, FHA's capital-reserve ratio fell below the congressionally mandated level of 2 percent for a second year in a row. While I recognize that FHA is in a stronger fiscal position this year than it was in 2009, I would like to hear when these reserves will return to their mandatory levels and how FHA intends to keep these reserves from dipping below 2 percent in the future.

I have serious concerns about the current vacancies in both the FHA Commissioner and the Federal Housing Finance Agency Director positions. In a still very fragile housing market, all agency oversight positions must be filled without disruption and I will continue to remind the President.

Mr. Secretary, I know you realize how serious these issues are and I look forward to hearing your plans to keep FHA solvent and off of the backs of the taxpayers as we consider alternatives to the Federal Government's role in financing the housing market.

MUTUAL MORTGAGE INSURANCE FUND

Senator MURRAY. Thank you very much.

I think you answered my question that I was going to ask you about the independent audit on the Mutual Mortgage Insurance Fund (MMI Fund), and why you felt it was necessary to raise that premium again.

Can you just give me a quick glimpse on how you determined the size of that increase, and just let us know what your thinking is on that?

Secretary DONOVAN. Yes. We did very careful analysis of the impacts that we would see, both on the capital reserves, but also looked at what barrier it might pose to access to home ownership, and analyzed that across a range of income groups, a range of markets, and felt that 25 basis points was the right balance of helping to build our reserves and yet not impacting particularly underserved communities that we've seen have been particularly hurt by the downturn. And so, we felt it was the right balance.

I also would just have to add a thank you to the subcommittee for working with us. It would not have been possible to implement that—a premium increase, which goes into effect on April 18—without the very strong partnership that we had with this subcommittee as well as your colleagues on the Banking Committee to get that passed very quickly and give us that flexibility. So, thank you again.

Senator MURRAY. Okay. Over the last 2 years, FHA has implemented a series of reforms which you talked about in your written testimony. These changes will improve the quality of new loans being insured, but the MMI Fund problems right now stem from the loans that FHA endorsed in prior years—particularly those that it took on in the height of the housing boom. So, the size of the losses facing FHA will be affected by the overall recovery of the housing market, which, as we know, continues to deal with foreclosures and depressed home values. In fact, the current discussion on the housing market is about the possibility of a double dip in home prices.

Are you concerned about a possible double dip?

Secretary DONOVAN. Certainly the data that we've seen over the last few weeks has raised concerns about where the market is going. We have seen declines in house prices pretty consistently over the last few months, as well as, after a number of months of increasing existing home sales, a decline. There is some information through pending home sales that we may see home sales start to trend up. And obviously, as we're entering the spring and the summer selling seasons, which are the strongest seasons of the year, we're going to be watching very, very closely.

What I would say is, really, two things. First of all, rightly, as you point out, our ability to ensure that we continue to grow the capital reserve—there are many factors that we control. We've taken enormous steps forward—again, working with this subcommittee and the Banking Committee—to improve our enforcement. We need to continue to do that so that we weed out bad lenders and can enforce against problems that we've seen with our existing book.

But beyond that, I think the most critical thing that we can do is to hold servicers accountable to helping those that can remain in their homes to do that. And frankly, what we have found in our investigations of FHA servicers is a consistent pattern of not helping borrowers soon enough in the process—and that is a lose-lose situation. It's a loss for that homeowner, obviously—devastating impacts; it's a loss for that community, where homeowners who are paying their bills, are current on their mortgages, see their house prices decline even further; and it's a loss for the servicers and the investors in those loans, because they, where they could help that family recover and continue to see them pay, will end up taking deeper losses on those loans because they haven't helped those families stay in their homes.

So, that's why I'm very focused, and working closely with my colleagues in the Administration, the State Attorneys General, to hold those servicers accountable and to make sure that we help families who can stay in their homes, stay in their homes. Mark Zandi has said that if we can help an additional 500,000 borrowers to stay in their homes, he thinks that could make the difference between a double dip and a stronger recovery in the housing market. So, that is a critical focus that I have in making sure that we hold not just FHA servicers accountable, but all servicers accountable.

LENDER OVERSIGHT AND ENFORCEMENT

Senator MURRAY. I personally appreciate the focus you've put on oversight and enforcement that you've just talked about. We know that at the height of the housing boom, really, too many loans were poorly underwritten and putting people in unaffordable mortgages, and here we are.

I know, I've watched carefully and seen that you've really increased the enforcement. I know the Mortgagee Review Board meets regularly now, and it's removed nearly 15 times as many lenders in the last 2 years than in the previous 9 years combined.

Can you talk a little bit about how that enforcement has actually impacted FHA's financial standing and the performance of FHA lenders?

Secretary DONOVAN. I think the most direct impact of that is that what we've seen is substantially improved quality of loans that we're making. As we've weeded out bad lenders, we've seen our early payment defaults decline substantially. And frankly, all of that comes back to benefiting the taxpayer. We have out-performed the predictions, as I said earlier, not just of our own actuaries, but dramatically out-performed the predictions that CBO had for the performance of our loans. And that is, I think, the most responsible thing that we can be doing, particularly given the context—as you said, the elephant in the room today is this broader budget discussion. And the President has talked about smart government. I think FHA is a very good example of how, through better managing government, we can ensure that we have benefits—not just to homeowners, but to taxpayers as well.

Senator MURRAY. I very much appreciate that. Thank you.

Senator Collins.

Secretary DONOVAN. Thank you.

FHA UNDERWRITING

Senator COLLINS. Thank you.

Let me follow up on the issue of problem lenders and HUD's efforts to protect the FHA Insurance Fund from bad loans. I note that HUD has made enormous strides in this area in recent years, and I want to give you credit for that. But, nevertheless, the inspector general continues to have concerns regarding HUD's oversight of its underwriting program, despite the significant actions that HUD has taken.

For example, there's a recent inspector general report that says the Department missed critical chances to recover up to $11 million in losses to the FHA's Insurance Fund on bad mortgage loans. And what was more troubling to me is the inspector general raised the concern that there are still systemic problems with the underwriting of FHA-insured loans, and the resulting costs for the Insurance Fund for loans that just never should have been insured in the first place.

In the sample that the inspector general conducted, it found that lenders did not properly underwrite 140 of the 284 loans reviewed—that's almost 50 percent—because they were not properly following FHA requirements. Similarly, there was a very recent story in USA Today that talked about a New York mortgage company that had been flagged in October 2007, and it says that HUD knew back then, or, FHA knew back then that this company, Cambridge Home Capital, posed a danger to homebuyers and repeatedly violated the agency's safe lending standards. Even so, FHA continued to approve mortgages for this company until June of this year, and that was nearly 3 years after the agency had flagged this company as being potentially fraudulent.

What is being done to ensure that when FHA's early warning system, which is the database that flags problem lenders, identifies a lender, that there is swift action to prevent that lender from continuing to make more mortgages that are insured by FHA?

Secretary DONOVAN. Senator Collins, first, let me just start by saying, I am very proud of the work that we've done to increase enforcement. And in fact, the partnership that we've had with our inspector general has been, I think, very strong. The inspector general report, the report that you talked about, was actually focused on lenders that we brought to their attention, and had identified as problem lenders through our systems, and I would just quote from Ken Donohue when he testified last May, that he had seen FHA do more in the last year than he had seen in all of the previous 8 years combined as inspector general. So, I think we've made substantial progress.

And in particular, I would point to the fact that we have done more enforcement actions—I think, Madam Chair, you just cited this—15 times more enforcement actions in the past year than we'd done in the 9 previous years combined.

Having said that, are we perfect? Do we still have a ways to go? We are not perfect. We still have a significant distance that I think we can go, and we should go, to strengthen those tools. And I would really point to two things: Too often today, our—what we call—postendorsement technical reviews, which are really one of our ways of catching these problems, are manual, or, we don't have the depth of automated systems that we need. One of the critical things that we worked with this subcommittee to do last year was to create the Transformation Initiative (TI).

One of the two largest investments we're making with TI is to create a much more sophisticated set of systems within FHA that would allow us to have a structural way, a systemic way, of identifying potential fraud and poor underwriting much earlier in the process. So, I want to make sure that we continue to work together to invest in the state-of-the-art technology that will allow us to identify that fraud on a systemic basis earlier.

The second thing I would say is, we still have limitations in our statutory authority to be able to go after some of the worst lenders, and in particular, to go after some of the principals. And it is frustrating to us, for example, that we can only terminate a branch, or a region of a lender, but not terminate the entire company from operating in FHA through our Neighborhood Watch system. That is one of the legislative changes that was proposed in legislation last year that we got close to getting done but we didn't get done. I would really like to make sure that we continue to work with the Banking Committee to get further authority to allow us to enforce more strongly.

Senator COLLINS. Thank you.

Secretary DONOVAN. Thank you.

Senator MURRAY. Senator Blunt.

FHA COMMISSIONER VACANCY

Senator BLUNT. Yes. I have one more set of questions here that I hope will be pretty quick.

Mr. Secretary, last month David Stevens, the FHA Commissioner, who'd only been on the job 6 or 7 months, I think, I think started last July, announced he was going to leave and become president of the Mortgage Bankers Association. You haven't had a permanent Director at the Federal Housing Finance Agency (FHFA) since 2008. I'd just like your comment. What are we doing here, and how is this hampering your efforts as Secretary, not having these positions filled—and when we do fill one, I think that was confirmable, and the person's confirmed, and then they come and go so quickly, as——

Secretary DONOVAN. Yes. Actually, Commissioner Stevens was at FHA for closer to 2 years. He was a nominee right when we came into office. It took roughly 3 months for him to get confirmed. And so, he was there, and that is not atypical for a commissioner to stay for 2 years. And frankly, he was pretty clear, having worked in the private sector, that he would return there at some point. But I think the important thing there is that we have built a very strong team within FHA. With Dave's help, we brought in the agency's first ever Chief Risk Officer, Bob Ryan. The President asked Bob to be Acting Commissioner during this period. And I'm fully confident, with his work, the work of Vicki Bott, and Carol Galante's leadership, that there is a very, very strong continuity, and that while we will be nominating a successor in the coming weeks, I'm very confident that the work that we've done continues.

On the FHFA post, to be frank, I think, we were frustrated. We had nominated an outstanding candidate in Joe Smith. And because of delays in the ability to get confirmed, he was asked to take on increased responsibilities in the State of North Carolina and made a decision when the last Congress ended in December that he would withdraw from the process, given the delays that we've had. And so, I think it's absolutely critical that we have a strong permanent nominee and leader at FHFA. I think Ed DeMarco's done a good job as Acting Commissioner. But the confirmation process there has really stood in the way of our being able to get a permanent leader at FHFA.

Senator BLUNT. Thank you.

Chairman, I'm sure you're probably involved in these discussions to try to cut down the number of people that have to go through this process. I'm supportive of that and hope that we can give more attention to the people that we think absolutely need attention, and be less of an impediment to leadership in the Government generally——

Senator MURRAY. I'll agree with that.

Senator BLUNT [continuing]. So, thank you, Chairman.

RISK-RETENTION RULE

Senator MURRAY. Thank you.

I just have a couple more questions. I wanted to ask you, as we continue to think about how to create a stronger, safer housing system—managing risk is going to be a central concern. And we have to be very careful not to overcorrect.

Looking at the administration's proposed rule for risk retention and the definition of a qualified residential mortgage, I do have some concerns about the impact of a 20-percent downpayment requirement. I get the skin in the game. I understand that. But when I think about the high cost of housing in my State, the idea of middle-class families trying to come up with 20 percent of a downpayment on a mortgage is really daunting. And I really worry that we're putting home ownership out of the ability of many middle-class Americans today with that.

FHA demonstrated last year when it announced its new tiered downpayment system that credit risk is more than just about loan to value ratio—it's also about creditworthiness. So, the risk-retention rule calls for 20 percent. But I saw that you also have an alternative for 10 percent. Can you talk a little bit about why you put that out?

Secretary DONOVAN. I think you've just made an eloquent case for why it's important that, as we are discussing this rule—it's a proposed rule—that we have a vigorous debate about the proper balance between downpayment requirements, and access and affordability. Home ownership has been, continues to be an important gateway to the middle class. And we've made, in our broader housing finance reform proposal, a strong case that FHA needs to continue to be a critical source of access to home ownership by insuring that first-time homebuyers, for whom a downpayment is typically the biggest barrier to home ownership, can continue to get access to the wealth building and the stability that home ownership can provide.

So, there's no question the downpayments affect performance. But too often, I think, in this debate we focus on downpayments and don't focus on the other aspects of underwriting—whether it be credit history, whether it be debt-to-income (DTI) ratios, the nature of the products that we're talking about—all of those are critical steps. And what we've learned from the crisis is, it's really when you start to layer risk—low downpayments with high DTIs, with poorly chosen products for that homeowner—all of those, when you layer them on top of each other, lead to exponential increases in risk. And so, we thought it was very important, as we put out the rule, to have an alternative in the preamble that focuses on a 10 percent downpayment, rather than a 20 percent.

Again, we want to make sure, as we finalize this rule, that we have this full and open debate. I do think it's important that, in particular, we ensure that we don't pull up the drawbridge, if you will, to those who can be successful homeowners in this debate.

Senator MURRAY. Yes. And as you know, getting the downpayment, can be a huge barrier, but the question is, for many homeowners, were you able to make the mortgage payment every month? So, creditworthiness has to be an important part of that, and I appreciate your thoughts on that. And we'll continue to follow it.

The same question can be asked about the GSE reform. Do we put in place so many barriers and changes that we don't allow average middle-class families to be able to get into the market? And you put forward three proposals on that. Are you thinking about that in the same context?

Secretary DONOVAN. Absolutely. I think part of the question is really about what happens in a moment of crisis like we've been through, and ensuring that we can step up our response in a responsible way, just as I think FHA's been able to do through this crisis.

But there's also a fundamental question about, what does our housing finance market look like in normal times? There's no question that we went too far.

Senator MURRAY. Yes.

Secretary DONOVAN. Seller-funded downpayments, all of the, frankly, crazy products that we saw. People making loans that we knew families couldn't afford on the day those loans were made. We have to get back to safer, saner products, there's no question. But we have to think about as well, as we've acknowledged, that relative to the crazy place that we were, the cost of housing finance is going to go up—we have to balance that, those increases in costs, the strengthening of underwriting standards, with really looking carefully at the data and understanding where we are confident that families can be successful homeowners. And I think we've had that experience in FHA, and that we really bring that to this debate as we will go forward.

Senator MURRAY. Yes, and I appreciate that. I mean, we all know that we went too far, the market went too far. But we can't overcorrect and create a situation that makes it impossible for people to purchase homes. So, it is a tough balance, and I appreciate your thoughts on that.

Senator Collins.

FDA'S RISK EXPOSURE

Senator COLLINS. Mr. Secretary, I'm curious what the impact has been on FHA's risk exposure as a result of the increase in the higher mortgage limit that FHA is insuring. Has that increased the risk exposure for FHA?

Secretary DONOVAN. Because the loans that we've made at these larger loan limits are relatively young—they're relatively new loans—it's too early to definitively say whether the performance of those loans is better or worse than other loans, and whether they would increase the risk exposure. There have been some faulty studies, frankly, that have looked at this.

Our best estimate at this point, as we look at it—obviously, with Bob Ryan's work as the first Chief Risk Officer, this is an issue he's looked carefully at—and the early data that we have shows that those loans perform roughly the same as the rest of the portfolio. So, I think it's fair to say that moving to those larger loans—particularly given that the highest-cost loans represent a relatively small share, as the loans that are above $625,000 represent only around 3 percent of our lending—that we really haven't seen a significant change in our risk profile as a result of the higher loan limits. But, we should continue to look at that as these loans age.

Senator COLLINS. Because they're pretty young loans.

Secretary DONOVAN. Yes.

Senator COLLINS. What percentage of FHA's insured loans are delinquent at this point?

Secretary DONOVAN. Let me get specifics. What I will say is both our seriously delinquent share and our 30-plus day delinquencies have declined quite consistently over the last roughly 15 months. So, from the beginning of last year we've seen fairly significant declines. We're in the range of 8 percent today—serious delinquency at 8.2 percent today.

And I would just point out, we'd be happy to get you more data that looks at this in a range of ways. We analyze this by how recently the loans were made, as well. And one of the most encouraging things we see is, when we separate out recent originations, we see dramatically lower early payment defaults, and at just about every stage, as they age we've seen significantly lower defaults on newer loans.

I would also point out that our defaults remain about one-third of the performance of subprime loans. And so, while we do have somewhat higher serious default rates than, for example, prime loans in the GSE books, if you look at them compared to the subprime default rates, which are well more than 20 percent—serious delinquencies—it's a dramatic difference, and that you can see the sort of consistent, safe underwriting that we've done coming through in that.

CAPITAL RESERVE RATIO

Senator COLLINS. My final question, because I know that we do need to adjourn, concerns the capital reserve ratio. It's my understanding that the ratio is currently below the congressionally mandated level of 2 percent, and I know that last year HUD established a performance goal to restore the excess capital reserve ratio of the MMI Fund to the mandated level of 2 percent by the year 2014.

Could you give us an update on whether you believe that at the end of this fiscal year you will improve over last fiscal year? And are you on track to reach the congressionally mandated level by 2014?

Secretary DONOVAN. Based on everything that we know today, we are somewhat ahead of the path that was laid out in the actuarial review last year, which was to be able to get back to the 2 percent by 2014.

The reason for that is because we have outperformed predictions that the actuarial review made in a range of areas, to the point where, as I said earlier, our projection is that our receipts would be about almost $10 billion this year. Our volume's down a little bit in the last few months. It may be that they come in somewhat lower than that. But that's substantially higher than what the actuary predicted and, as I mentioned, CBO. So, the indications are good.

There are two cautions I would give to that. One is that we have seen a buildup in pending foreclosures, so we're not realizing claims on those. Because we've seen delays on behalf of lenders, particularly with the problems that we've found in servicing and in the foreclosure process, many lenders have gone back to re-look at those processes. So, I think it's fair to say we will see a jump in claims as those foreclosures proceed—at least some of them—in the coming months.

I think the larger issue, though, is what we don't control. The single largest factor in the performance or where we are in the actuarial review in the capital ratio is the direction of home prices. We were relatively conservative in the projections that we used—they're independent projections, but I think they were relatively conservative—they predicted a more than 5-percent decline this year in house prices.

There's nothing that concerns me at this point in terms of the performance being worse than was projected in the actuarial. Having said that, if we do see a slowdown in the broader economy—whether it's the effects of what's happening overseas or other issues that would slow down the economy—a jump in interest rates, those kind of broader macroeconomic effects and the way that they affect house prices, is the single biggest variable that we, frankly, don't control with our actions at FHA, that could impact where we are on the capital reserve ratio.

I don't want to get in the business of predicting or saying I'm absolutely confident that we'll be in a stronger position next year. All indications are that way, but there's lots of time between now and then for the market to evolve.

Senator COLLINS. Thank you.

Senator MURRAY. Thank you very much.

And, Mr. Secretary, thank you so much for your statements this morning.

ADDITIONAL COMMITTEE QUESTIONS

We will leave the record open for any additional questions to be submitted, and we look forward to your responses.

[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

OPERATION WATCHDOG RECOMMENDATIONS

Question. Last month, the Department of Housing and Urban Development (HUD) Office of Inspector General (OIG) issued a report based on "Operation Watchdog", an initiative prompted by the Federal Housing Administration (FHA) concerns over increasing claim rates. This OIG focused its attention on Direct Endorsement (DE) lenders, and discovered instances where HUD failed to identify problems in underwriting resulting in claims paid on unqualified FHA loans. The OIG has recommended that FHA implement procedures to review riskier loans and that HUD seek administrative remedies to recover losses. I understand that one of the FHA legislative reforms being sought is indemnification authority against DE lenders, which would address part of the OIG's concern.

How HUD is working to address the OIG recommendation?

Answer. In recent years, FHA has significantly strengthened its ability to review and evaluate mortgagees' underwriting and servicing operations for compliance with HUD requirements. Even before Operation Watchdog was announced, FHA had been taking stock of its oversight and enforcement activities and had begun to initiate several changes to its policies and practices. Recent changes include:

—The expansion of the Credit Watch Termination Initiative to include DE mortgagees. This endeavor allows FHA to evaluate lender underwriting performance on a quarterly basis and take action to quickly terminate poorly performing lenders.

—The development of comprehensive lender performance metrics and reporting. These reporting capabilities significantly improve FHA's ability to analyze and evaluate lender performance in order to timely identify lenders whose performance poses potential or actual risks to FHA.

—The pursuit of statutory authority to require indemnification by DE mortgagees. At present, FHA only has authority to request rather than require indemnification from DE mortgagees. Therefore, the Department has eagerly sought legislation that would expand its authority to require indemnification from these lenders.

—A comprehensive overhaul of FHA's loan-level review procedures. This effort has yielded improved risk-based targeting and evaluation methodologies and better aligned the Department's various loan review processes to more effectively identify loans that do not comply with FHA's requirements.

—The development of a comprehensive counterparty risk management information technology (IT) solution. Employing state-of-the-art technologies and practices, these new IT tools will improve HUD's risk analysis and recognition capabilities throughout the FHA lending life cycle.

In sum, FHA is executing substantial changes to its policies and procedures that are dramatically improving the Department's ability to identify and mitigate risks to its insurance funds, via the development of risk-based monitoring and analysis, implementation of strengthened oversight and enforcement mechanisms, and the acquisition and utilization of substantially improved technologies. FHA is ensuring that it possesses the tools necessary to conduct its business in ways that are consistent with industry best practices and appropriately protect the Department's insurance funds. These changes were underway long before the release of the Operation Watchdog audit report. Operation Watchdog merely validated that the improvements FHA is pursuing already are both necessary and appropriate.

Question. Why does HUD lack the authority to recoup losses against these types of lenders and how will the legislation you are seeking address this?

Answer. FHA-insured single-family mortgages are originated and underwritten through the DE process, which permits an FHA-approved DE lender to underwrite mortgages without FHA's prior review and submit them directly for insurance endorsement. High-performing DE lenders with acceptable default and claim rates may apply for approval to participate in the Lender Insurance (LI) Program, which enables them to endorse FHA mortgage loans without a pre-endorsement review by FHA. As of April 30, 2011, there were 1,859 active DE lenders. Of this total, 687 were approved for participation in the LI Program.

Current statutory authority at section 256(c) of the National Housing Act (12 U.S.C. 1715z–21) permits the Secretary to require indemnification if a mortgage approved by the Secretary pursuant to delegation of authority through the LI Program was not originated or underwritten in accordance with requirements established by the Secretary, and the Secretary pays an insurance claim within a reasonable period specified by the Secretary. If fraud or misrepresentation was involved in connection with the origination or underwriting, the Secretary may require the lender to indemnify the Secretary for the loss regardless of when an insurance claim is paid. This existing authority only applies to indemnification by LI lenders and does not include DE lenders that are not participants in the LI Program.

Therefore, FHA is seeking to extend the Secretary's authority such that HUD can require indemnification by all DE lenders, not simply those approved for participation in the LI Program. The Secretary's existing indemnification authority only provides recourse for FHA to avoid or recoup losses through required indemnification for loans that were improperly originated or underwritten, or in which fraud or misrepresentation were involved, from LI lenders. As stated above, only 687, or 37 percent, of DE lenders, are approved LI Program participants. Therefore, FHA would benefit from explicit authority to require indemnification from DE lenders, and thereby recover losses from the remaining 63 percent of lenders authorized to make underwriting and loan approval decisions on FHA's behalf. The current limitation on FHA's counterparty risk management authority with regard to DE lenders poses obvious and unnecessary risks to FHA's insurance funds. Extending the Secretary's authority to require indemnification by lenders to include all FHA-approved DE lenders will ensure that FHA will be able to mitigate losses arising from claims on inappropriately or fraudulently originated or underwritten loans.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION HIRING

Question. The budget for fiscal year 2012 requests authority to alter the way we fund the Government National Mortgage Association (Ginnie Mae) salaries and expenses. Instead of receiving direct annual appropriations, the budget proposes to allow Ginnie Mae to fund its operations using fees it generates under authority provided in appropriations bills.

I share the concern about ensuring that Ginnie Mae has the appropriate staff to monitor its growing portfolio, which is why the Senate bill for fiscal year 2011 proposed an increase above the President's budget request—which actually sought to reduce funding for Ginnie Mae staffing. However, I am not convinced that the proposal in the budget actually addresses all of the challenges with building Ginnie Mae's workforce. As I understand it, Ginnie Mae did not use all of the funding the Congress provided it last year, and it wasn't the first time Ginnie Mae lapsed funding. This suggests the problem isn't really a question of resources.

What has been the problem with hiring at Ginnie Mae, and given that you didn't use all of the resources allocated to Ginnie Mae last year, how would this language address the challenge?

New Funding Structure

Answer. The President's budget request for fiscal year 2012 includes a proposal to fund Ginnie Mae with $30 million in personnel compensation and benefits, and other administrative expenses through collections of multiclass and commitment fees. The proposal is forward looking and is designed to provide Ginnie Mae with flexibility to accommodate a multiyear hiring initiative. The administration's proposal provides Ginnie Mae with certainty as to the level of funding that will be available in the next year and thus, Ginnie Mae will be able to staff to that level of funding. With the new funding structure, Ginnie Mae's hiring would not be hampered by the uncertainty and interruptions sometimes caused by insufficient appropriations or continuing resolutions.

During the last few fiscal years, Ginnie Mae has sought an increase in its salaries and expense appropriation to increase our staff to better manage the housing crisis. Small increases were approved in fiscal year 2010 and fiscal year 2011 through reprogramming. However, in each of those years, a continuing resolution was in place holding agency expenditures to prior-year levels for part of the year making it very difficult for Ginnie Mae to take full advantage of the additional funds. In addition, even if reprogrammed funds are given in one fiscal year, there is no guaranty that the same reprogramming will be available the next fiscal year. Thus, in order to avoid beginning the next fiscal year at payroll higher than the base appropriated amount, Ginnie Mae has limited its hiring. The proposed funding structure will provide certainty as to the level of funding available and will allow Ginnie Mae to execute its multi-year hiring plan.

Lapsed Funds Due to Uncertainty

In recent years, HUD has not had an approved budget at the beginning of the fiscal year and has had to operate under a continuing resolution. The lack of certainty as to the funding level for the year has hampered Ginnie Mae's ability to move aggressively on its planned hiring schedule in the past few years. Under a continuing resolution Ginnie Mae receives a fraction of the previous year's approved salaries and expense budget until a full budget is approved.

SUPPORTING COMMUNITY BANK MORTGAGES

Question. According to estimates, nearly 70 percent of all mortgage originations flow through the big four lenders—JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo. In the aftermath of the housing crisis hundreds of small, community banks have failed. Yet, community banks serve an important role and are an important part of a healthy market. In your testimony you refer to reforms that you are proposing that would assist small, community banks.

Can you elaborate on the current problem, and how the reforms you are proposing would address it?

Answer. FHA began requiring the submission of audited financial statements from Supervised Mortgagees (i.e., banks, thrifts, and credit unions) because without receiving audited financial statements from these institutions, FHA was not able to adequately assess their financial stability and possession of sufficient capital. To put supervised lenders on par with FHA's existing requirements for other lenders, and to avoid potential losses from undercapitalized institutions, HUD decided to begin requiring supervised entities to submit audited financials. The failure of 157 banks in 2010 testifies to the prudence of this policy change.

For some small FHA-approved supervised lenders that originate low volumes of FHA loans the expense of obtaining an external audit of their financial statements is deemed too burdensome to justify their continued participation in FHA programs. Because many of these small supervised lenders are located in underserved communities that possess a limited selection of residential mortgage lending entities, small supervised lenders' relinquishment of FHA-approval may decrease access to FHA programs for some communities. Given FHA's present prominent role in the Nation's mortgage market, a reduction in the availability of FHA-insured mortgage credit could adversely impact the recovery of some States and communities. In order to accommodate the needs of such community banks, HUD issued a waiver in April 2011 of the new audited financial statement requirements for small supervised lenders. Small supervised lenders that meet the asset thresholds delineated by their Federal regulators (the current asset threshold being $500 million) will be permitted to submit a copy of their unaudited regulatory report (e.g., consolidated or fourth quarter Call Report or Report of Condition and Income, Office of Thrift Supervision Report, consolidated or fourth quarter Thrift Financial Report, Form 10–K, NCUA Supervisory Committee Audit) that aligns with their fiscal year end. These lenders will also be required to submit a report on their compliance with HUD program requirements.

The accommodations afforded to small supervised lenders, including community banks, represent an appropriate balance between FHA's management of counterparty risk and the Department's continued commitment to ensuring the participation of community banks and other small lenders in its programs.

Question. What other steps can be taken to make sure that small and community banks can compete for mortgage business?

Answer. In addition to the measures to assist community banks described above, HUD is also seeking legislative changes that will expand the opportunities for small banks and other lenders to participate in FHA programs. Another option by which community banks and other small supervised institutions may participate in FHA programs is through a sponsored origination relationship. Sponsored originators are not subject to FHA lender approval, but are permitted to originate FHA loans by partnering with an FHA-approved underwriting mortgagee. Community banks that wish to continue originating FHA loans, but that do not want to be subject to FHA lender approval requirements and processes, may act as sponsored originators.

Many community banks have cited their inability under the National Housing Act to close loans in their own names should they forfeit their FHA approval as a deterrent to their acting as sponsored third-party originators. FHA has proposed an amendment to 12 U.S.C. 1709(b), which has been included in comprehensive FHA Reform legislation, that would allow sponsored third-party originators to close loans in their names, addressing what has been a chief concern of small community banks in considering a switch in status from FHA-approved mortgagee to nonapproved sponsored third-party originator. The passage of FHA's proposed amendment (which passed the House last fall) would provide yet another sensible solution for small community banks, while enabling FHA to continue prudently managing its risk and mitigating losses to its insurance funds.

Additionally, the passage of the proposed amendment to the National Housing Act would significantly expand access to FHA programs for small business lenders of all types without unnecessarily increasing the risk to FHA. FHA strongly encourages the Congress to pass the proposed amendment in order to protect FHA insurance funds and accommodate the interests of community banks and other small lenders.

SUBCOMMITTEE RECESS

Senator MURRAY. And thank you again for everything.

Secretary DONOVAN. Thank you. Get us a budget.

Senator MURRAY. All right. Thank you.

This hearing is recessed.

[Whereupon, at 10:24 a.m., Thursday, April 7, the subcommittee was recessed, to reconvene subject to the call of the Chair.]