AN EXAMINATION OF THE FEDERAL HOUSING ADMINISTRATION AND ITS IMPACT ON HOMEOWNERSHIP IN AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING,
COMMUNITY DEVELOPMENT,
AND INSURANCE

OF THE

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AN EXAMINATION OF THE FEDERAL HOUSING ADMINISTRATION AND ITS IMPACT ON HOMEOWNERSHIP IN AMERICA

Thursday, December 5, 2019

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING,
COMMUNITY DEVELOPMENT,
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Wm. Lacy Clay [chairman of the subcommittee] presiding.

Members present: Representatives Clay, Cleaver, Sherman, Beatty, Green, Vargas, Lawson, Axne; Stivers, Luetkemeyer, Huizenga, Tipton, Zeldin, Kustoff, Gonzalez of Ohio, Rose, Steil, and Gooden.

Also present: Representative Hill.

Chairman CLAY. The Subcommittee on Housing, Community Development, and Insurance will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

Today's hearing is entitled, "An Examination of the Federal Housing Administration and Its Impact on Homeownership in America."

I now recognize myself for 4 minutes to give an opening statement.

There was a time when the Federal Housing Administration's (FHA's) policies explicitly denied access to the American Dream of homeownership to Black families and people of color, making owning a home a privilege afforded primarily to white Americans and contributing to the racial wealth gap as we know it.

As of the third quarter of 2019, the white homeownership rate is 73 percent, compared to nearly 48 percent for Latinos and 43 percent for Black homeowners.

Today, FHA plays an important role in our housing finance system that is helping to ensure that access to homeownership is broadly available. In Fiscal Year 2019 alone, FHA helped over 615,000 borrowers become homeowners for the first time, with over

33 percent of FHA market endorsements serving minority borrowers, and over half serving low- to moderate-income borrowers.

FHA also plays a vital role in expanding access to affordable rental housing through its multi-family insurance program. Yet, in the midst of the current affordable housing crisis, it burdens so many families with unaffordable rents. Secretary Carson chose to terminate FHA's partnership with the Federal Financing Bank, which provided low-cost financing for affordable multi-family housing loans.

FHA is designed to play a countercyclical role in the housing market, meaning that its market share expands when the private market recedes. This helps provide long-term stability to the housing market, particularly during economic downturns. Thankfully, the markets and overall economy have been trending well, due in large part to the focus and driven policies of the Obama Administration.

Yet, there remain concerns that FHA is failing to take adequate measures to help borrowers avoid foreclosure, including elderly borrowers with reverse mortgages. In addition, immediately following President Trump's inauguration, HUD suspended a planned quarter-point decrease in annual FHA insurance premiums for most FHA-insured mortgages.

According to research from the National Association of REALTORS, roughly 234,000 creditworthy borrowers were priced out of the home buying market in 2014, solely due to FHA's high premiums. Despite the strong financial health of FHA's Mutual Mortgage Insurance Fund and calls from advocates and stakeholders to lift the suspension, HUD leadership has maintained this suspension indefinitely. This decision has diminished the homeownership opportunities in St. Louis and across the State, and the nation, locking many hard-working families into rentership and exacerbating the racial wealth gap.

With that, I look forward to hearing the testimony of Mr. Montgomery today. I yield back.

I now recognize the gentleman from Ohio, Mr. Stivers, the ranking member of the subcommittee, for an opening statement.

Mr. STIVERS. Thank you, Chairman Clay. I really appreciate you holding this hearing today.

Commissioner Montgomery, I appreciate you being here before the subcommittee today. I know you wear multiple hats at HUD, and today we welcome you in your capacity as Commissioner of the Federal Housing Administration (FHA).

FHA has a critical mission: helping individuals achieve their dream of homeownership. Achieving that dream has real consequences. Homes act as savings vehicles and are long-term investments that generally appreciate in value. In other words, owning a home and building equity helps families generate wealth. In fact, according to a 2018 study by Duke University, reducing disparities in homeownership by race would narrow the racial wealth gap by 31 percent.

Earlier this year, when some of my colleagues on the other side attacked the idea of gentrification, I urged them to join me in addressing a real solution to the real problem, and that is the disparity in racial homeownership. And I want to call on the chairman today to work with me on those efforts because I think we both believe in that and want to work on that in the future.

And, Commissioner Montgomery, I would ask you to join us as we try to address that effort because I think it is a very important effort to help ensure everybody can achieve the American Dream, and I want to talk more about that.

FHA, I think, is a very important tool in that, and we should view FHA and private mortgage insurance as important tools for helping people climb the economic ladder. But, that ladder needs to be stable. Families cannot climb the FHA ladder if the insurance fund is imploded before they get there.

Commissioner, you have now served in HUD in different roles in three Administrations—for President Bush, President Obama, and President Trump—so I know you have real bipartisan credentials of working in three Administrations of different political folks.

Your time spent in public service gives you some unique insights into the housing sector and how it has evolved during and after the financial crisis. I want to hear some of that today. I am sure your experience has given you an appreciation for FHA's importance as a countercyclical buffer, as the chairman talked about, and I think that is really important, particularly important during downturns, but also understanding how razor-thin the FHA insurance fund is right now. And although it is a lot better than it was, it is still not where we want it. That puts taxpayers at risk.

I appreciate all the work you have done to rebuild FHA's fund, in fact, to its highest level in 12 years, and I want to congratulate you for that. I think there is still more to be done, and I am glad that we are not putting it at risk by artificially cutting rates before the fund is stable.

It also begs the larger question of, how can we further reform and strengthen housing finance reform by transferring risks from the taxpayers to the private sector? The Federal Government has a terrible record of pricing risk, and you only need to look as far as the Federal Flood Insurance Program to see that. FHA sometimes does that, too. But by the same token, government can also be less capable of determining which individuals are good risks and therefore should pay less.

So, I think there are some reforms we can do on pricing. Instead of a one-size-fits-all approach that uses the private sector for price discovery, some unique partnerships in the future. And I look forward to talking with the chairman and you about that because I think some folks deserve to actually do a little better.

With that, I ask unanimous consent to insert an opening statement from Ranking Member McHenry, the ranking member of the full Financial Services Committee, into the record this afternoon, Mr. Chairman.

Chairman CLAY. Without objection, it is so ordered.

Mr. STIVERS. Thank you, and I yield back.

Chairman CLAY. The gentleman from Ohio yields back.

Today, we welcome the testimony of Commissioner Brian Montgomery of the Federal Housing Administration.

The witness is reminded that your oral testimony will be limited to 5 minutes. And without objection, your written statement will be made a part of the record. You are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF THE HONORABLE BRIAN D. MONTGOMERY, COMMISSIONER, FEDERAL HOUSING ADMINISTRATION (FHA)

Mr. MONTGOMERY. Thank you very much, Mr. Chairman, Ranking Member Stivers, and distinguished members of the subcommittee. I am honored to appear before you to discuss the progress and improvements FHA has made recently in the areas within our programs that warrant further attention.

FHA has made significant progress in improving the financial performance of its insurance fund, mitigating risks within its programs, reducing regulatory burdens, and modernizing its technology platforms. The successes of these actions were presented to you last month in our 2019 Annual Report to Congress on the State of the Mutual Mortgage Insurance (MMI) Fund.

As you know, Congress has a statutory minimum 2 percent capital ratio with the MMI Fund. The capital ratio is a strong indicator of the fund's financial health and includes our forward and reverse mortgage products.

Our annual report showed that the capital ratio increased from 2.76 percent last year to 4.84 percent in Fiscal Year 2019, well above the mandatory 2-percent minimum. Additionally, the MMI capital, what we used to refer to as economic net worth, was $62 billion, more than its $27.5 billion from the previous year.

While the improved health of the MMI Fund is welcome news to us all, the number of households served by FHA is equally good news. In Fiscal Year 2019, FHA insured forward mortgages for almost one million households, of which 616,000 went to first-time home buyers.

FHA remains an important option for minority communities, as well. In fact, last year, minorities represented 36 percent of all FHA purchase mortgage borrowers, compared to just 20 percent in conventional lending channels.

HUD's Housing Finance Reform Plan submitted to the President in September proposes a number of recommendations to further reduce risks to the MMI Fund, to protect taxpayers, and to ensure that FHA maintains its focus on providing mortgage financing for low- to moderate-income families not served by traditional underwriting.

All of the recommendations in HUD's plan are important. Several priorities are particularly noteworthy for the purposes of today's hearing.

One priority is the need to radically modernize FHA's information technology infrastructure. Our single-family business currently runs on 15 different systems, many of them on antiquated mainframes, and some of which are more than 40 years old.

In early 2019, HUD formed a highly-qualified FHA Modernization Project Team, started by gathering business requirements for every element of the loan life process, from application to origination, servicing, and through claims processing. Working with single-family staff at headquarters and in the field, this team has an ultimate objective of fully digitizing the entire loan lifecycle.

HUD is very grateful that Congress appropriated an initial $20 million specifically to modernize our single-family technology systems earlier this year, and that both the House and Senate Appropriations Bills for Fiscal Year 2020 would provide an additional $20 million.

However, we have a ways to go. Ultimately, we need $80 million to $90 million in total funding to complete these critical and long-overdue modernization projects.

Beyond our financial health and IT infrastructure, improving FHA's operational ability to serve our customers is also a critical priority, and this is an area where we have made great strides. For example, we have dedicated significant focus to improving single-family default processes. This is making it less burdensome to service FHA loans, while ensuring that our loss mitigation options protect taxpayers and promote sustainable homeownership.

Additionally, our Disaster Standalone Partial Claim implemented last year to assist homeowners impacted by 2017 disasters will now be a standard mortgage relief option available for all people impacted by major disasters. This allows many homeowners to resume payments without modifying their loan or re-amortizing the loan term, avoiding both the foreclosure process and payment increases. It also streamlines income documentation and other requirements to expedite relief.

Looking forward, we must focus on seeking the right balance between facilitating access to mortgage credit and better managing our risk. Our mission is to make certain FHA remains a stable and reliable resource to provide housing finance support to first-time home buyers and other underserved borrowers. I believe that is a mission that we all share.

Again, I want to thank the subcommittee for your time today, and I look forward to your questions. Thank you.

[The prepared statement of Commissioner Montgomery can be found on page 34 of the appendix.]

Chairman CLAY. I want to thank you, Commissioner, for your testimony today.

Also, we are in the middle of a vote series on the House Floor, so at this time, we are going to recess, and we will immediately reconvene after the last vote and get back over here. Thank you for your patience with us.

We stand adjourned for votes.

[recess]

Chairman CLAY. The subcommittee will return to order.

Let me thank our witness for your patience. We are now ready to proceed under the 5-minute rule, and I will yield myself 5 minutes to begin the question phase of the hearing.

Over the last year, HUD has taken a number of actions to reduce the ability of FHA borrowers to utilize down payment assistance programs from governmental entities to purchase a home, and has indicated that it again intends to issue a proposed rule affecting government down payment assistance in January.

Secretary Carson testified before this committee in June that he was not familiar with the HUD data that identifies which government entity is providing down payment assistance. It appears that HUD cannot determine which government programs are providing down payment assistance on any FHA loan, which is critical before attempting to issue new regulations for any government down payment assistance program.

Will you commit to not moving forward on any rulemaking or other administrative changes related to down payment assistance provided by governmental entities until HUD is able to collect data on individual governmental entities and has analyzed a statistically significant amount of data on the performance and pricing of FHA loans with down payment assistance from each specific governmental entity? Can you expound on that, Commissioner?

Mr. MONTGOMERY. Yes. Thank you, Mr. Chairman.

As you know, down payment assistance (DPA) has a long history at FHA. When I was Commissioner last time, a certain type of down payment assistance ultimately cost FHA more than $16.5 billion in losses, according to our independent actuarial review.

Chairman CLAY. Did you say 16 or 60?

Mr. MONTGOMERY. Sixteen and a half billion dollars in losses.

Chairman CLAY. On down payment assistance? Tell me how that worked.

Mr. MONTGOMERY. Sure. This type of down payment assistance, which is no longer permitted, actually put the down payment on the mortgage. So while it was technically called a gift, it was a gift you ended up paying for. As you can imagine, the default rate on those loans was almost—

Chairman CLAY. Wait, wait, wait.

Mr. MONTGOMERY. —5 times as much.

Chairman CLAY. Okay. Down payment assistance is normally used to help first-time home buyers or those who qualify in that manner to help them get into a home. It is not a significant amount, but it closes the gap to get cheaper loans. So, tell me what the problem is?

Mr. MONTGOMERY. I just want to make sure that any down payment assistance provider is doing so within what our rules permit, whether it is jurisdictional, whether it is if they financially benefit off of the transaction, which the Housing and Economic Recovery Act (HERA) does not permit.

So, I will commit that any effort to undertake rulemaking will be deliberate. It will be based on research and facts as we know them.

Again, we just want to make sure that any DPA is done in the best interest of the borrower and is not there to enrich the people who are providing it.

Chairman CLAY. No, and I agree totally with that perspective, that the DPA should be done in the interest of the borrower. And you and I know it goes to close the homeownership gap, and there are other benefits to the DPA. And, so, I would just hope we could reach some kind of accommodation that the data would back up any decision made by the Department.

Let me ask you, one of the first actions that the Trump Administration took upon being sworn into office was to suspend a planned reduction in FHA's annual premiums by 25 basis points, which would have saved the average borrower $500 in the first year alone.

In response to calls from advocates to allow the premium reduction to be implemented in light of the FHA's improved financial health, Secretary Carson stated that he would keep the rate as low as he could, consistent with the law. But since then, the Secretary has not only maintained the suspension on premium reduction, but he has proposed to arbitrarily increase the capital ratio far above what is statutorily required.

Does Secretary Carson still stand by his original statement that he will keep premiums as low as possible, consistent with the law?

Mr. MONTGOMERY. Thank you, Mr. Chairman.

In many ways, I run a $1.4 trillion corporation, so I have to carefully monitor our cash inflows and obviously our cash outlays. We consistently look at premium structure, whether—it is hard to say this one is too much or too little.

We are looking at, do we have the right structure in terms of how much is on the upfront or how much is on the annual? This is something we consistently look at and will continue to do so through this first term.

Chairman CLAY. I thank you for your responses. I now yield 5 minutes to the ranking member of the subcommittee, my colleague from Ohio, Mr. Stivers.

Mr. STIVERS. Thank you, Mr. Chairman. I want to thank you for holding this hearing. It is very important, and I think there are a number of issues that I want to try to illuminate and work on.

Commissioner, thank you for being here. I appreciate your service in three Administrations—two Republican, one Democrat—and the fact that you have worked to shore up the FHA insurance fund to meet the 2 percent statutory capital requirement. That is a very important—that is already not a lot of money, but that is the minimum required, and I appreciate you getting it there and keeping it there. That is a great accomplishment. It is something I have been concerned about for a long time.

I mentioned a couple of things in my opening statement, and I would like to follow up on them if that is okay with you. The first thing I talked about was whether you might be willing to work with the chairman and I and stakeholders to address the disparity in homeownership by race. Is that something that you might be willing to work with us on?

Mr. MONTGOMERY. Absolutely, sir. In fact, we convened an internal working group on this several months ago to look at minority homeownership because, as you have articulated in your statement, it is down.

Mr. STIVERS. I think the chairman mentioned the statistics in his opening statement. Obviously, that disparity is too great, and it leads to a disparity in wealth, as well, because it is the biggest savings vehicle that most people have.

So, I want to again thank you for your willingness to work with us. We very much look forward to working on that topic. It is a very important topic because the American Dream needs to be accessible by every American. It is something all of us believe in. It is something that you believe in. We want to work together to find a way to figure out what is driving the disparity and figure out how to address that disparity. So, I really appreciate that commonsense approach. We look forward to working with you on that.

The second thing I mentioned was the fact that the one-size-fits-all FHA premiums do not give a potential risk-based discount for people who are of lower risk. Would you be willing to work with us and potentially stakeholders and even folks in the private sector, because, given the government's history of mispricing risk, I think there are a lot of private sector mortgage insurance companies and others that could help in a partnership with you as we try to figure this out.

Is that something that you would be willing to work with us, and maybe some outside private entities on, to figure out if we can find a way to do something like that to make sure that people who deserve a little bit of a break, get a little bit of a break, even if we limit that break?

Mr. MONTGOMERY. Absolutely, sir, and thanks for your question.

As I mentioned, we just want to make sure we are not intruding on private capital. As you know, there are private mortgage insurers out there that work with the Government-Sponsored Enterprises (GSEs).

Mr. STIVERS. And I think they can be part of the solution. They have very elaborate systems and data.

And one of the other things that I did not mention to you, but we have talked about privately is, I am so happy that Congress gave you $20 million, a down payment to update your IT infrastructure.

I understand you are now using Abacus 2.0, so that is a start. But I would really like to make you a little more modern than that, so I know we need to work to make sure we continue to give you the resources you need to upgrade that. The chairman and I had a little aside where we both acknowledged that we need to help you invest in your technology.

But, I think, I want to again acknowledge you can partner with some outside industry that have the data and the computing systems to help you as you do this, including our private mortgage insurers. There is no reason you need to compete against them when you could actually work with private industry and make it a win-win for everybody. Is that something you would be open to?

Mr. MONTGOMERY. Absolutely. There are certain things we are prohibited from doing by statute, but—

Mr. STIVERS. The great thing about statutes is that we can change them, Mr. Commissioner.

Mr. MONTGOMERY. Absolutely. We are certainly open to that, and we are very thankful for the down payment on our technology upgrades. This is something I tried to get through when I was Commissioner last time. I know the previous Administration tried, as well, so we are very happy that Congress got us on the good trajectory to get us to a better place in our technology.

Mr. STIVERS. Thank you. I just want to mention one other program that sometimes gets much maligned, and let you talk about it for a minute, because what you guys have done to make the reverse mortgage program work—and reverse mortgages are not for everybody. But just because they are not for everybody, does not mean they are not for anybody.

I want to give you a second to talk about what you have done to help make sure that those programs have the right guardrails around them to protect senior citizens, but also are there for people who might need cash flow and have that biggest saving vehicle I talked about, their home.

Mr. MONTGOMERY. The reverse mortgage program provides a great social motion; it helps seniors age in place. You are right. It is not for every particular senior; it depends on their situation.

But it is, obviously, like a lot of things, impacted by the housing collapse. It seemed to be the very top of the apathy in terms of volume, was at the time when house prices came down, obviously the Home Equity Conversion Mortgage (HECM) Program was impacted by that.

The previous Administration made some headway in dealing with this, working with Congress through the Reverse Mortgage Stabilization Act.

We, thankfully, because of good house price appreciation and some other changes that we made, seem to be heading in a much better place than we were last year, and thus being able to help seniors age in place.

Mr. STIVERS. Thank you. I yield back, Mr. Chairman. Thank you, Mr. Chairman.

Chairman CLAY. Thank you.

The gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

I thank the witness for appearing. How are you, sir? It is good to see you again.

I am concerned about the role of expanding access to homeownership, as well, and it is good to hear that the chairman and the ranking member are working in this area.

One of the things that we have been looking at is additional credit scoring. Some call it alternative credit scoring. Have you any intelligence on this, any research that has been done, anything that you are doing in-house that might be of benefit?

Mr. MONTGOMERY. Thank you for that. When I was Commissioner last time, you may recall that we worked together with your office and some of the affinity groups in real estate saying, well, we are not quite sure which way to go with alternative trade lines, alternative credit score models. It struck me at the time, and it still does today, that if we were to do a pilot program looking at that, that FHA, I think, would be the appropriate place to conduct that pilot.

Technology has moved substantially since 2006, 2007, and there are more players in the industry. And if you look at the statistics, 25 to 35 million Americans either have low credit scores or they have thin-file credit.

And I just think, I believe my R&Rs. I want the data to back it up. I think there is a way to responsibly, and in the best interest of borrowers, look at non-traditional credit in ways that might open the aperture somewhat.

Mr. GREEN. For those who may not understand the term, "non-traditional credit," would you kindly give some explanation, please?

Mr. MONTGOMERY. There are several different models out there. There are some that look at so-called traditional credit, credit cards, auto loans, things of that nature, and maybe score them a little differently than others.

There are others that look at cell phone bills, utility payments, rent payments, things of that nature, and factor your payment history into that, as well. And there are some that do a little of both.

So, again, I do not have all the answers to it today. I just think a prudent approach would be to conduct a pilot and to see where that would take us, which, as you know, sir, was put into HERA in 2008 but for whatever reasons, the pilot was never implemented.

Mr. GREEN. Yes. I think—

Mr. MONTGOMERY. And the authorization ran out.

Mr. GREEN. I do recall that it was legislation that I had the good fortune to sponsor. And you did work with me.

As you know, we have tried to maintain the traditional model and only add additional information, additional information about the lights, gas, water, phone, and cable bills. And I have to continually emphasize, we do not decide that we are going to eliminate the traditional model. All of that stays there. But there are some people who benefit from having a rich payment history in these other areas, and that helps them.

I find it interesting to note that at yesterday's hearing, we had representatives from five agencies here, including the Fed, the FDIC—actually, it was three; the OCC was not present. They have a joint communique where they have indicated that this is something worthy of consideration.

So, it looks like we are moving in that direction. It is just a question of, how long will it take us to have that pilot program that you are talking about?

I am working with my friends on the other side to see if we can collaborate and come to some reasonable conclusion as to how to move forward with this.

Would you just respond to the notion of maintaining the traditional model and simply adding additional credit? This is why I say "additional" as opposed to "alternative", because it causes some people to believe that we are going to forego the traditional model, and that is not at all what we are talking about. Your comments, please?

Mr. MONTGOMERY. Sure. Again, sir, I think there is a way to do it. I think we would both agree it should be done responsibly and in the borrowers' best interests.

But remember, that will be a two-way street. So, whereas you may have a good payment history in some of those non-traditional trade lines, if you also begin to pay late, you are going to feel that, as well. It's no different than if you pay your credit card bill late or make your automobile payment late, as well.

So, again, I just want to make sure, sir, that the committee understands that if we were to do it, we think we should look at it in ways that are in the best interests of the consumer and done responsibly, and it strikes me that FHA would be the appropriate vehicle to use to do that.

Mr. GREEN. Thank you.

Mr. MONTGOMERY. And HUD, in general.

Mr. GREEN. And you and I have talked before. Why don't we have an additional conversation on this? My time is up now, but let's have my staff get with you so that we can make an appointment and flesh this out.

Mr. MONTGOMERY. Yes, sir.

Mr. GREEN. Okay.

Mr. MONTGOMERY. I'd be happy to. Thank you.

Mr. GREEN. Thank you. I yield back. Thank you for the extra seconds, Mr. Chairman.

Chairman CLAY. The gentleman's time has expired.

The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Welcome, Commissioner Montgomery.

I want to start off with a question with regards to the False Claim Act. A Memorandum of Understanding (MOU) was recently announced between HUD and the Department of Justice on the use of the False Claim Act. I am just curious, could you give me some details on this, what you hope it will accomplish, and I guess from the standpoint of how big a barrier has the False Claim Act been? And what do you hope the MOU would—how will it affect the mortgages and make them more accessible or whatever? Can you help us out?

Mr. MONTGOMERY. Sure. Thank you, sir.

When I was Commissioner last time, we had a pretty good balance between the percentage of lenders who were depositories and non-depositories. We are kind of out of balance now. About 13 percent of our originations now come from depositories. As recently as 2010, it was about half.

Most of them will tell you they point to the False Claim Act as the reason they got out of the FHA program. Some of them got out of the VA Program.

It is not my intent to take sides in that argument between independent lenders and depositories. I just think, for a lot of reasons, we need to find equilibrium there, and a lot of the consumer advocate groups agree with me on this point. They see it as an access-to-credit issue because a lot of families who have banking relationships at a large depository, who are first-time home buyers, are finding that their depository does not offer the FHA program, which has been the nation's flagship homebuying program since 1935. To me, that just seems a little odd.

That is not to say that we look the other way with fraud or people who do not follow by our rules. Quite the contrary. We just think somewhere between an indemnification and the equivalent of a drone strike on a lender that—in this case, they just got out of the program. There needs to be something in between.

The Justice Department, working with our general counsel, and our staff—we found a good place that I think brings a little more focus to the program. It gives FHA and HUD a bigger voice in saying, okay, this rises to the level of the False Claim Act, and therefore we would recommend or concur with Justice going forward.

Mr. LUETKEMEYER. You made a statement a minute ago that 13 percent are from depository institutions and the other 87 would be from independent—

Mr. MONTGOMERY. Yes, sir. Credit unions.

Mr. LUETKEMEYER. Credit unions would fall—they are depository institutions?

Mr. MONTGOMERY. They would fall under the depositories.

Mr. LUETKEMEYER. So, independent would be what, the Quicken Loans of the world? Is that what you are talking about?

Mr. MONTGOMERY. Yes, sir. Lenders like Quicken. Some are privately-owned. Some are publically-traded.

Mr. LUETKEMEYER. Offline and online lenders and offshore and all that kind of stuff?

Mr. MONTGOMERY. Well, you have to be approved, obviously.

Mr. LUETKEMEYER. Okay.

Mr. MONTGOMERY. We have criteria for that.

Mr. LUETKEMEYER. It is an amazing statistic. It kind of took me by surprise here. I was not prepared for that.

Mr. MONTGOMERY. We were just happy that a lot of consumer groups, including the Center for Responsible Lending, the National Community Reinvestment Coalition (NCRC), and others were on our side on this topic.

Mr. LUETKEMEYER. Okay.

Mr. MONTGOMERY. And that helped.

Mr. LUETKEMEYER. Great. Thank you. I appreciate you explaining that.

Also, with regards to the risk in your portfolio, obviously things are going well. We are increasing the capital account. But we have noticed that the credit scores seem to be going backwards. There are some earlier defaults and some debt-to-income ratios are rising. Should we, as a Congress, be concerned about that? What are you doing to address that? Is that just the nature of the economy? What is going on there, because—

Mr. MONTGOMERY. I will try to boil down an hour-long response, sir. We conduct daily stress tests on our portfolio. And we have been concerned about the number of loans that come in with risk layering, which is a combination of high debt-to-income ratio, low credit scores, and loans that came in from about August of 2016 up until we made a change to the TOTAL Scorecard.

We are modeled at about a 1.4 capital ratio the last loan end. That is not where we want to be. Congress requires us to have a minimum 2 percent. So, we made some changes to the TOTAL Scorecard that went into effect in March of this year. They seemed to be having their intended effect. It seems like we stopped the 3-year slide in credit scores. They have actually leveled off and improved one point—

Mr. LUETKEMEYER. I want to ask one quick question before my time expires.

The concern is that, even though you are very well-capitalized right now, you apparently have more risk in your portfolio than you would normally have. So, in order to be able to accommodate more risk, you are going to have to have more capital in order to be able to continue to be a solvent entity and have enough reserves there to ride this out until you get this portfolio back in shape, I would assume. How long do you think it is going to take to do that?

Mr. MONTGOMERY. Certainly, the house price appreciations helped, and a strong economy. Again, we just want to make sure—we call it "turning the dial"—we have access to credit. We want to make sure, should there be a downturn, that we have an ample amount of reserves to weather that.

Mr. LUETKEMEYER. Okay. Thank you very much.

Mr. MONTGOMERY. It is sort of a tricky dance, but we think we are managing it well.

Mr. LUETKEMEYER. Well, we will be watching. Thank you very much. I appreciate it.

Chairman CLAY. The gentleman's time has expired.

The gentlewoman from Iowa, Mrs. Axne, is recognized for 5 minutes.

Mrs. AXNE. Thank you, Mr. Chairman, and thank you, Commissioner Montgomery, for being here. I very much appreciate it.

We have been talking a lot today, of course, about increasing homeownership and addressing the shortage of affordable housing across this country. So, one of the issues I want to take a look at is manufactured housing because, in many cases, it can cost up to 30 percent less, and in some cases, more, for folks to be able to afford that.

If we are going to talk about it, though, we have to make sure it is a way to provide affordable housing and truly make sure that it is. I do not know if you are aware of what has occurred in Iowa over the last year or so, but I would love to give you a brief background.

Unfortunately, a company named Havenpark Capital, which is a fund from Utah, has bought now seven manufactured housing communities in Iowa, and then they proceeded to raise the lot rents for the residents there between 20 and 70 percent. So, they came in and just raised the rate 20 to 70 percent for these families, many of whom are on fixed incomes.

I visited one of those communities, Midwest Country Estates in Waukee, and saw firsthand the terrible position that these folks are really being put in. And just yesterday, I spoke to one of those residents, Matt Chapman, who is about to be paying 70 percent of his income for housing.

We know the standard definition of severely cost-burdened is paying 50 percent of your income on rent, and here is a constituent who owns his home outright, has no mortgage, and has to pay 20 percent more than the 50 percent that we think is severely cost-burdened. So, he does not know what he is going to do, and many of his neighbors just do not know how they are going to make this happen. It is just simply unaffordable for so many residents like him and others across the country.

Many of these properties were purchased with federally-supported loans, so we need to make sure that our constituents are not being taken advantage of because they cannot relocate. And these are the kinds of predatory practices that, unfortunately, are being allowed to continue.

So, Commissioner, I have been working on trying to find solutions to prevent this from happening again. Given your experience in housing, I just wanted to ask you, what recommendations do you have that we should be putting in place?

Mr. MONTGOMERY. And I would be happy, by the way, to follow up when we have more time to discuss it.

But manufactured housing is—22 million Americans live in manufactured housing. We regulate the construction of manufactured housing throughout the country. Between my time as Commissioner last time and this time, the technology, the construction standards, and all of that have made leaps and bounds, so much so that we are almost having a hard time keeping up with it.

We have also been looking at the financing aspect relative to FHA. There is Title I and Title II, not getting too in the weeds here. Title I does not have a lot of volume in it, tends to be more sort of what I call chattel loans, versus the traditional FHA Title II.

We think there is a way to make it more affordable because, you heard me reference earlier in my opening statement, the average income of a manufactured-home owner is between $30,000 and $50,000 a year. And, again, it is part of the things we are looking at in sort of a pro-consumer aspect, ways that we can perhaps get some of that cost of financing down.

We have less purview, being honest with you, on sort of the structure of communities. Again, more so the regulation of the actual manufacturing of it, of the structure.

Mrs. AXNE. Okay. I appreciate that, and I would love to see what information you have.

At least three of these seven properties were bought with Fannie Mae loans, so it is not as if the Federal Government is not involved in it.

I hate to see—we believe that they actually overpaid, as well, for the community that I was just talking with you about. I am sure they did. And I think that we could have—if we had had pieces in place, those owners could have pooled together and possibly purchased it for themselves and been able to stay in their homes.

And not just to afford it, but when we see these kinds of predatory actions, they are asking children to literally give up their dogs because they are too big for the homes, according to their new rules.

They are forcing families to tear down swing sets that they do not think are, I guess, good-looking enough. But these are not people who can afford those $2,000 or $3,000 Rainbow sets that some other people can.

So, any help that you can give us, these people truly have been put in a position where they do not know what their answer will be. Many of them will not be able to afford this and will be forced out of their homes, including taking their children with them and not being able to find an affordable option.

I would appreciate your follow-up on some of those things we just talked about and any other things that you think we could put in place.

Mr. MONTGOMERY. Absolutely. I will look forward to following up with you or your staff on it.

Mrs. AXNE. Thank you.

Mr. MONTGOMERY. Thank you.

Chairman CLAY. The gentlewoman yields back, and the gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman. Commissioner, welcome.

The FHA's recent report to Congress showed that the FHA's financial health is in just about the best shape it has been in since the financial crisis, and I appreciate your stewardship on that.

But I did want to follow up on maybe some potential areas that could impact that, and I would like to talk about the Property Assessed Clean Energy (PACE) loans. These loans have been used in some cases to trick some seniors and other vulnerable citizens into taking out high-interest energy loans for green energy appliances and using their homes as collateral. In some of these cases, it has actually squeezed these Americans to the point of foreclosure.

Do you believe that the use of these PACE encumbrances on FHA-insured loans poses a risk to the health of the MMIF and the FHA's current policy on PACE-encumbered loans?

Mr. MONTGOMERY. Thank you for your question. What makes us overly concerned about that is we do not know how many. As you know, we do not allow it on new FHA loans and have not for several years. But it is unknown, if you are an existing FHA borrower, how many try to take out PACE loans.

We think solar power and all of that is fine. Our concern is that those loans prime ours. They step in front of the National Housing Act, which I think we would all agree is probably not a good thing. Again, working with the Federal Housing Finance Agency (FHFA), as well, because they are equally concerned about how can we work together to make sure that does not happen.

Mr. TIPTON. And I think there is across-the-board agreement, as you note, to be able to have good, sensible energy use to benefit our people.

But would there be some benefit in being able to have some national clarity on PACE loans? Because we do have some States where they have authorized programs that have been enacted on ability to repay, laws and licensing requirements for the PACE lenders, and other States have not. So, would that national clarity be of some use?

Mr. MONTGOMERY. Again, we are infinitely concerned because of it priming our loan, which is sacred in our world, that we have to be in a first-loss position. So, we are concerned about it, but it's something, again, that we continue to work on with FHFA, and we certainly welcome the opportunity to work with you, as well, sir.

Mr. TIPTON. We appreciate that. I think, again, we all support all of the above energy policy, but we do not want it putting people into a position where they actually lose their homes.

On another topic here, due to the lower FHA premiums, plus a more expansive qualified mortgage (QM) definition, currently, approximately 55 percent of the FHA purchase loans exceed a 43 percent debt-to-income (DTI) ratio.

And artificially high fees, such as Loan-Level Price Adjustments (LLPAs) charged by the GSEs of many of the borrowers, drive the FHA to secure mortgage financing for no other reason than the FHA loan is cheaper, at least initially.

The combination of these policies does create an un-level playing field and advantages the 100-percent backed FHA program and gives the consumers ultimately fewer choices.

Would you agree that these inconsistent and sometimes arbitrary differences are driving borrowers into the markets?

Mr. MONTGOMERY. We certainly look at risk characteristics, including the use of risk layering. DTI by itself, just like credit scores by itself, is not necessarily the prime decision tool, if you will. We look at them in the aggregate.

As you know, touching this issue is the QM Patch, which is slated to go away in January of 2021, which would essentially push a lot more of those higher DTI loans toward us.

So, without going down that path in the limited time, I will just say DTI is something we look very carefully at, knowing that by itself, it is not the end-all, be-all in terms of credit risk. But it certainly accounts for something. Whether or not we would need to put some sort of residual income test in like the Veterans Administration does, again, are all things we are looking at in a total access to credit review of the portfolio.

Mr. TIPTON. Thank you for that. And, I guess, finally, what I would like to know is—I come from a rural part of America, and a lot of our focus in these committee hearings is on urban America and on housing issues that are there. What actions is FHA taking to help rural communities across the country?

Mr. MONTGOMERY. Certainly, in terms of loan limits, looking carefully at what the loan limits are in those communities.

And we mentioned manufactured housing as a viable opportunity. In multi-family, the GSEs tend to concentrate in urban areas, and FHA and USDA tend to focus more in rural communities in terms of developing multi-family properties.

Mr. TIPTON. Thank you, and I yield back, Mr. Chairman.

Chairman CLAY. The gentleman yields back.

The gentleman from Florida, Mr. Lawson, is recognized for 5 minutes.

Mr. LAWSON. Thank you, Mr. Chairman, and welcome to the committee, Commissioner Montgomery.

So I can get a clear understanding, what is the average homeowner's loan that FHA insures for a family of two that is applying for a loan?

Mr. MONTGOMERY. Looking at the data from Fiscal Year 2019, our average borrower made about $62,000 a year, bought a $183,000 home, and more than likely, used about $8,000—or about half of them used down payment assistance, and that average was about $8,000.

Mr. LAWSON. Okay. And does that require that the—I think the down payment used to be, what, 10 percent, or less?

Mr. MONTGOMERY. For us, sir, it is 3.5 percent. We call it the minimum cash investment. But it is 3.5 percent.

Mr. LAWSON. Are those fixed loans?

Mr. MONTGOMERY. We do have an ARM product. Most people do a fixed product.

Mr. LAWSON. Okay. Now, in areas like where I am from, where there has been a lot of disaster from hurricanes and people's inability to recover right away, what programs have you implemented in order to try to help those homeowners so they will be able to maintain their property until they can get back on their feet?

Mr. MONTGOMERY. The primary thing that we want to do is—FHA assistance typically comes in later, after FEMA, after SBA, after whatever insurance they have on the home.

We have any number of products. As I mentioned in my opening statement, a product that we originally used in Hurricane Katrina, we used in Puerto Rico, the Standalone Partial Claim, which allows us to immediately go and assess a home buyer's situation and take any arrearages they have and put them as a soft second lien on that mortgage and not change the amortization, not change the term of the mortgage or anything.

We had some pretty good success using that in New Orleans and also in Puerto Rico. We have now made that standard as of a couple of months ago, going forward, to use in other disasters.

We also have a product that, if your home is completely destroyed, there is an FHA product, the 203(H), I believe, that allows you to get 100 percent financing if your apartment or whatever has been destroyed as a result of a hurricane.

Mr. LAWSON. My next question is centered around two individuals. Can two individuals who are not married apply for an FHA loan? And how would you handle that if they do?

Mr. MONTGOMERY. They have to either be married, either common law married—you could not as just roommates, your best friend or whatever, apply together. I think that is more of a bank requirement than ours.

Mr. LAWSON. Okay. Would FHA's Housing Financial Administration's Risk Sharing Program expand Ginnie Mae's authority and involvement in affordable housing at increased risk to the Federal Government?

Mr. MONTGOMERY. The multi-family risk share program, I think, is a perfect model of the Federal Government working together with developers and State HFAs. That program still exists.

There was another part of it, the Federal Financing Bank, if that is where you were headed, that that is no longer permitted. But, the ideal solution would be for Ginnie Mae to sort of securitize those loans that are done using the FHA Risk Share Program, which has an extremely low default rate.

Mr. LAWSON. Okay. How do you go about calculating the debt to savings ratio for those who apply?

Mr. MONTGOMERY. We have what are called front-end ratios and back-end ratios, you know, looking at your bills with and without your mortgage payment. Front-end is 31; back-end is 43. With compensating factors, you can go as high as 57, 58 percent.

Mr. LAWSON. Okay. With that, Mr. Chairman, I yield back.

Chairman CLAY. The gentleman yields back.

The gentleman from Tennessee, Mr. Rose, is recognized for 5 minutes.

Mr. ROSE. Thank you, Mr. Chairman.

Commissioner Montgomery, thank you for being here with us today.

First, I would like to commend you and Secretary Carson for your work to restore the financial health of the FHA. I believe we should all be pleased that the Mutual Mortgage Insurance Fund's capital ratio increased to 4.84 percent last year, which is, of course, well above the statutorily required 2 percent minimum, and the highest it has been since Fiscal Year 2007.

Just yesterday, I met with the Tennessee Housing Development Agency, the THDA, to discuss a number of housing issues facing

Tennessee. THDA helps ensure housing is available and affordable to people in every county, including many of the rural and often underserved counties in Tennessee's Sixth District.

Providing down payment assistance is an important aspect of what State housing finance agencies do. HUD has legitimately raised concerns about the performance of FHA mortgages with down payment assistance, but I believe that down payment programs managed through State HFAs do considerably better than in those managed by some others. I know in Tennessee, THDA has been providing down payment assistance responsibly for over 4 decades.

Commissioner, as HUD contemplates new rules around down payment assistance programs, do you plan to take into consideration these kinds of distinctions rather than trying to implement a more sweeping approach?

Mr. MONTGOMERY. Thank you, Congressman, for that question. When George W. Bush was Governor, I worked at the State of Texas Housing Finance Agency, and we were probably the largest at the time. I have met with the National Council of State Housing Agencies (NCSHA). I have met with State HFAs. As a matter of fact, I am meeting with NCSHA on Monday while they are in town.

As I have told them, as we look at DPA at large, the type of DPA provided by State and local HFAs is not my worry, not my concern. As I referenced earlier, when I had a similar question, I just want to make sure any DPA that is provided by other entities works within our program guidelines from a financial benefit perspective, which is not allowed, and from a jurisdictional requirement. And that is what we are carefully looking at. We all do this just to help ensure that it is done with the best interests of the borrower, not enriching someone providing down payment assistance.

Mr. ROSE. Thank you. As I have said before in previous committee proceedings, manufactured housing is incredibly important to my district. Manufactured homes account for 13.1 percent of occupied housing units in my district, compared to 7.1 percent in the greater United States.

HUD's Housing Reform Plan recognizes that there is a need to update FHA's guidelines for its manufactured housing programs, but such changes have also been pending for a number of years. I want to echo Ms. Axne's concerns about the changes.

And for you, what will you do to implement the necessary changes as soon as possible?

Mr. MONTGOMERY. One thing I think is long overdue, is we need to elevate the status of that office, and we would like to work with you on that to make it run by a Deputy Assistant Secretary, which it is not. We want to separate it out.

As I mentioned before, when I toured a plant when I was Commissioner last time, and I toured one earlier this year, the technology upgrades have been tremendous in that industry.

My affection for that industry was born—again, back to my State of Texas HFA days, where at some point, there were more new manufactured homes sold in Texas than there were stick and bricks homes, which is kind of hard to believe. But there was a point in time where that happened. I firmly believe it is a viable option and a darn good one to help families, mostly in rural communities.

Mr. ROSE. One thing that continues to concern me is that the volume of manufactured home loans being supported by FHA continues to decline. As you mentioned, Title I program loans are almost nonexistent. Although the vast majority of manufactured homes are financed as chattel, FHA financed only 526 chattel homes last year. Without access to FHA financing, many families are unable to attain the dream of homeownership through manufactured housing.

Commissioner, where are updates to the FHA's financing programs for manufactured housing on HUD's overall priority list?

Mr. MONTGOMERY. Part of our look at the FHA program in its entirety includes spending more time on Title I and on Title II as it relates to manufactured housing, which, you know, to be on a foundation.

So, it is too early to give you any sort of direction which way we are going. We know the numbers are low. But again, we just want to make sure any changes we made are done with the consumers' best interests at heart.

By the way, to get back to your previous question, we have picked up the pace in looking at these new sets of standards that have come out of the Manufactured Housing Consensus Committee regarding stairs, garages, carports, even second floors. I think we are getting caught up. But the committee is moving quickly. We are just trying to catch up with them.

Mr. ROSE. Thank you, and I yield back.

Mr. LAWSON. [presiding]. Okay. Thank you.

The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on National Security, International Development and Monetary Policy, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. Commissioner, thank you for being here today.

On Tuesday evening, Congresswoman Joyce Beatty from this committee, and Congressman William Lacy Clay from Missouri, who chairs this committee, and I had a Midwest summit. We brought people in here for a dinner summit meeting from all over the Midwest, the upper Midwest and lower Midwest, and we talked with them about a number of issues.

Then, we listened to what they thought, and they did not surprise us in the fact that they believe that affordable housing, or the lack thereof, is in a crisis. I do not think that there is a need for much imagination to see that that is in fact the truth.

And, so, in terms of all of the things that we need to be doing to correct that problem, I am a little concerned about HUD's Finance Reform Program. Even if you work with the GSEs, I am concerned that if you are trying to reduce the HUD footprint, the crisis will become even more critical.

My belief is that this is the time for us to be more creative. We need to become more of a thrift—an agency that is only concerned about giving everybody money for them to buy homes, that is not what I am saying. We do not want you to be a spendthrift agency.

But I would feel comfortable—and I think what I am saying is, millions of other people would, as well. If we had programs, as you are looking at reform, that are trimmed, but also sufficient enough to make a difference. And right now, we are going in the opposite direction.

It is difficult to get developers to do something unless they—if you are going to do affordable housing in the urban core, you are going to have to have some kind of subsidy. Municipal subsidy, low-income tax credits. You are going to have to have something or it just won't work. The numbers do not work.

So, can you assure me that we are not going to start eliminating Section 202 programs? We are not going to start—well, you do not have any control over the CDBG, but many of the communities need CDBG in order to help developers get started, if only with infrastructure.

So, can you fill me in on the reform program and what you think ultimately will happen?

Mr. MONTGOMERY. Certainly. Thank you, Congressman.

In terms of multi-family housing, obviously 202 and 811.

The RAD Program, which is helping renovate hundreds of thousands of units around the country.

We have now launched a program for new construction for FHA with tax credits.

We also are now permitting the RAD Program to be used with the 202 program. These have all happened in the last year.

On the single-family side, there is not a lot we can do to help build supply. Although, through this affordability council that was started up a few months ago, we want to help kind of pull back the curtain on a lot of the local decision-making, whether it is zoning or set-asides. It is driving up the cost of housing in many communities to where they are building very little entry-level housing. And the cost to manufacture a mortgage, for example, has gone up almost twice from what it was 10 years ago.

So, there are a lot of factors present out there that do give us concern, but many of them are born of decisions made at a State or local level that we have less control over.

Mr. CLEAVER. I agree. But I have towns in my district, like Higginsville, like Marshall, like Sweet Springs, like Orrick, like Mayview, where they have not had a new house built in decades, or certainly over a decade, and they need help.

There used to be a program called Urban Development Action Grants (UDAG), that did not come out of your shop, but out of HUD, and those programs allowed for municipalities to help a developer get started, and programs. So, I think the HUD side is going to have to become more active, and maybe your request for them to become more active would result in more affordable housing.

I appreciate the time. I wish that we had more.

Mr. MONTGOMERY. I would just add the Opportunity Zones. They are now seen as an excellent way to help expand housing and have made some adjustments, as I articulated in my opening statement, that I think will help create more supply and more investment in those Opportunity Zones.

Mr. LAWSON. Thank you.

The gentleman from New York, Mr. Zeldin, is recognized now for 5 minutes.

Mr. ZELDIN. Thank you to Commissioner Montgomery for being here today, and thank you to Chairman Clay and Ranking Member Stivers for holding this hearing.

FHA loans are essential products for Long Island families looking to purchase a new home that will help them build their own version of the American Dream, and most importantly, help them stay on Long Island.

Oftentimes, these loans are made to first-time home buyers, the constituency that often has the means to make the monthly mortgage payments, but also often has the most difficulty having enough capital for a large down payment. These are middle-class people with good jobs and good credit scores, but maybe they are not liquid enough to put up a large down payment in a region with some of the highest real estate values in the nation.

Over the past several years, we have seen traditional lenders, like banks, flee the FHA market due to overzealous enforcement of the False Claim Act by the previous Administration. This law was intended to prevent fraud against the U.S. Government, not for immaterial mistakes, like a misplaced comma on a mortgage application.

I, along with my friend, Representative Gottheimer, introduced legislation last Congress to bring a fix to this frivolous liability. In May, I had a great conversation with Secretary Carson regarding that issue in this committee. Since then, HUD and DOJ have entered into an MOU on how to evaluate False Claim Act cases.

Commissioner Montgomery, with HUD's recent announcement regarding entering into an MOU with DOJ on the use of the False Claim Act, do you expect to see an increase in the availability of affordable FHA loans?

Mr. MONTGOMERY. I would think that as more and larger traditional depositories re-enter the program, I would think that is good for consumers, especially those who already enjoy a relationship with that depository institution. I think some of them are concerned about the durability of our MOU with Justice.

And, by the way, with our certifications, which we updated, as well, meaning what happens with the next Administration—I think that what we have done with the MOU and with our revised certifications, I think we are addressing that durability issue by giving HUD a voice in this process, or the Mortgagee Review Board, which has been around by statute for 20, 30 years or so, to help them win justice; or when we believe a particular circumstance rises to the level of the False Claim Act, that we make that determination together, not unilaterally, which I understand might have been happening previously.

Mr. ZELDIN. I think you are bringing some very interesting and important points up. To that point, are there any legislative reforms needed to complement this administrative action?

Mr. MONTGOMERY. Again, I want to make sure I am drawing a bright line that we are not going soft on people who violate our rules. It is this False Claim Act with its treble damages, its civil money penalties, that drove some of the largest banks away from our program that has been around since the Great Depression.

Just in the interest of access to credit and fairness—again, not trying to take sides between depositories and independents—I just think it is better for consumers, and certainly better for us, to have depositories back offering our program. And, to their credit, some have signaled a willingness to get back in, while others have not, which disappoints me. But we are not going to give up.

Mr. ZELDIN. An important part of a modern FHA is the FHA Information Technology Fund. Can you elaborate on how vital funding the FHA Information Technology Fund is?

Mr. MONTGOMERY. This is something that, when I was Commissioner last time, we tried to get funding for. I know the last Administration did, as well, so we were very ecstatic that we got a down payment of $20 million, and hopefully we will get the remainder. We need about $80 million altogether.

We are going to completely change the way we conduct business now, which is hard-coded mainframes, heavy reliance on paper, and to move in the area of data-centric architecture, moving away from paper to fully electronic, single point-of-entry, and on par hopefully with what Fannie Mae and Freddie Mac have done. In fact, they have been helpful, as has FHA, in this effort.

We think we will realize some economies to scale, not just the ease of it and the streamline of it, but being able to better mind the data analytics behind the numbers. So, we are ecstatic to get the funding and will remain optimistic we will ultimately get everything we need.

Mr. ZELDIN. You certainly have been advocating for FHA modernization since you were first Commissioner under President George W. Bush, and it is important that you are continuing that effort. I thank you, Commissioner. Both the housing market and the taxpayers are in good hands with someone of your expertise and knowledge at the helm of the FHA.

I yield back.

Mr. MONTGOMERY. Thank you, sir.

Mr. LAWSON. Thank you.

The gentleman from Tennessee, Mr. Kustoff, is now recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman, and thank you, Commissioner, for testifying today.

We know that HUD released the annual report on the financial health of the Mutual Mortgage Insurance Fund. In the section detailing the emerging risk within the MMI Fund, the report does note that the projected lifetime claim rates for recent originations are at their highest levels in almost 10 years. Well, going back to 2009.

The report also highlights that this is due in part to early payment default rates increasing and that the average debt-to-income ratio increased for the sixth straight year.

Commissioner, if you could, what are some of the other drivers that you think are behind the increase in the higher risk credit characteristics in recent originations?

Mr. MONTGOMERY. You will recall, the Qualified Mortgage—the Dodd-Frank Act set the maximum DTI at 43 percent for reasons I am sure we all recall. The GSEs and us were given basically what they call the "patch" to go above that.

I just want to make sure it is clear that high DTI, in and of itself, is not a key predictor of how a loan is going to perform. To answer your question, when it has been combined with other high-risk characteristics, including low credit scores, that risk layering is what has given us some pause and what led us to make some changes to our TOTAL Scorecard earlier this year, which seem to be working. We seem to have slowed down the drop in credit scores, and that had been going on for about 3 years. They actually went up a point for the first time in a while.

Mr. KUSTOFF. You are saying the credit scores went up about a point?

Mr. MONTGOMERY. They were slow declines, or sort of steady state, for almost 3 years. And the changes that we put in place appear to, at least for the last 2 months, have stopped that.

Mr. KUSTOFF. I heard what you just said about the DTI ratios. That, combined with early defaults, combined with where credit scores are now, should those three factors and others concern Congress?

Mr. MONTGOMERY. They concerned us, which is why we made those changes to the TOTAL Scorecard in February, to manually refer those loans that have those risky characteristics, which essentially means that the lender now has to lift open the hood and look much deeper into the finances before they will approve the loan.

Mr. KUSTOFF. Kind of along a different line, how large of a role do cash-out refinancings play in FHA's endorsement portfolio?

Mr. MONTGOMERY. We are not anti-cash-out refinance. We were just concerned that we were becoming the government's ATM when a lot of Fannie and Freddie borrowers who were looking to refinance moved to refinance with FHA because the terms were better. So after, again, pouring over the data for several months, we recently made the change just to accept the policy that the GSEs currently use, which is 80 percent versus the 85 percent. So now, all three of us are aligned.

Mr. KUSTOFF. Very good. Can you give your opinion about how FHA can strike a better balance in doing business with both depository and non-depository lenders?

Mr. MONTGOMERY. Again, I think getting back to the previous question and others, making sure that the durability, that there is some longevity to this process with the Justice Department, which, again, using our existing Mortgagee Review Board, I think provides an elegant way to provide that durability to make sure that it is there to last.

When new Administrations come in, MOUs tend to not have much of a shelf life. But what we built into the certifications, which I do not want to get too granular here, we think helps provide a more rigorous durability to what we are trying to accomplish. Again, not to let people walk away when they run afoul of our rules, but to make sure that the penalty fits the transgression, if you will.

Mr. KUSTOFF. Thank you, Commissioner. We appreciate your service, and I yield back the balance of my time.

Mr. MONTGOMERY. Thank you, sir.

Mr. LAWSON. Thank you.

The gentleman from California, Mr. Sherman, is now recognized for 5 minutes.

Mr. SHERMAN. Thank you.

I want to focus on PACE loans. These are loans in every sense of the word practically, but technically, they are an increase in your property tax bill. They are used to help finance energy-efficient upgrades, often air conditioning systems.

As of January 2017, FHA no longer insures residential mortgages that have PACE loans attached to the property in a first position, as makes sense. You are in the business of being the first mortgage, and only with great creativity do we have a system where "first" can mean "second," because the PACE is first, and then the first is second.

I have a discussion draft I am circulating to say that for a PACE loan to be adopted, it needs the consent of the underlying mortgage holder. That seems only fair, if you bargain for first position, that you get to keep that first position.

What do you think should be done with regard to PACE loans, both to protect the mortgagor and to protect the homeowner?

Mr. MONTGOMERY. Thanks for bringing up the mortgagor, as well. There is not much I can do relative to the terms of how they are able to get the, say in this case, solar equipment, if you will.

Mr. SHERMAN. Yes. I know the CFPB is in the process of writing a rule, but I think we do an awful lot.

Mr. MONTGOMERY. Absolutely. And you are right. We permitted that on new FHA mortgages. It is the millions of existing ones that we are concerned about. And if you have some language in a bill or something, we would be happy to help you in that respect.

Mr. SHERMAN. So, a new FHA mortgage not only cannot be issued or underwritten if there is already a PACE loan, but you actually have language that prevents some new PACE loan from being—

Mr. MONTGOMERY. For a new FHA mortgage, that is—

Mr. SHERMAN. So if somebody signs up for an FHA mortgage today, or 6 months from now, they cannot do a PACE loan without the approval of the mortgage holder?

Mr. MONTGOMERY. Well, there is a seasoning requirement.

Mr. SHERMAN. Okay.

Mr. MONTGOMERY. I can't remember exactly what it is. But our concern, again, is on existing FHA loans that take out PACE loans that we are unaware of. And then, if something happens, we find ourselves now not in the first position anymore.

Mr. SHERMAN. Now, you guarantee mortgages. Others in the mortgage guarantee business stop charging a premium when you hit that 78 percent level. It is my understanding that you still charge, even if the homeowner has an awful lot of equity in the house and they don't really need mortgage insurance. Are you planning to change that?

Mr. MONTGOMERY. Sir, I appreciate your question, but I do not know of a mortgage insurance entity around that continues 100 percent coverage, unless you quit paying premiums, which would be the case if that were to happen.

FHA loans are also fully assumable, which is a great feature. But let's just say that it is beyond the 78 percent threshold. Someone could assume an FHA mortgage, get 100 percent coverage, yet not be paying a premium.

Mr. SHERMAN. Could you develop a system to reduce the amount the homeowner has to pay when the homeowner has a whole lot of equity in the property?

Mr. MONTGOMERY. That is a good question. And we have been looking at, as I referenced earlier, sort of premiums at large. Is it based on however long the average FHA mortgage is? Is there a way to find a little more balance? I would maintain, though, even though in the GSE space when private mortgage insurance goes away, there is a guarantee fee (g-fee) in place for the life of the loan.

Mr. SHERMAN. Yes, but we are talking about a much lower rate when you have a lot more equity.

I want to move on to one other thing. In the aftermath of a disaster, servicers frequently place loans in forbearance, providing time for the consumers to assess damages and recover. If the forbearance exceeds beyond 60 days, the loan is then reported as being in default and is recorded against the originating lender on the FHA neighborhood watch database, regardless of whether the home is in a disaster area. Particularly for the small lenders, even a handful of mortgages can lead to a significant impact on their default rate.

How can FHA ensure that lenders are not penalized for providing appropriate forbearance for borrowers struggling to make payment in a disaster?

Mr. MONTGOMERY. Thank you, sir. We have been careful to strike that balance between what we believe was an industry-leading loss mitigation program that worked well during the housing crisis. But translating that over into disasters, it is again something we are looking long and hard at, especially as it relates to disasters, which is why we made a recent announcement on the Standalone Partial Claim.

Mr. SHERMAN. Perhaps you could expand on the answer in the record. Thank you very much.

Mr. MONTGOMERY. I would be happy to, sir. Thank you.

Mr. LAWSON. Thank you.

The gentleman from Wisconsin, Mr. Steil, is now recognized for 5 minutes.

Mr. STEIL. Thank you, Mr. Chairman.

Mr. Commissioner, I want to start by commending you for leading FHA's Mutual Mortgage Insurance Fund to its best position in recent years.

FHA insurance is different from private mortgage insurance in that it remains for the life of the loan, whereas private insurance falls off as the borrower reaches a certain amount of equity in their home: 78 percent.

Do you agree that the ongoing nature of the risk of default demands life-of-the-loan premiums for FHA products?

Mr. MONTGOMERY. I believe so. And as I referenced in the previous question, if we are going to maintain 100 percent coverage, then we have to keep taking premiums on—

Mr. STEIL. So is a reduction of life-of-the-loan coverage essentially the same as a premium reduction in your eyes?

Mr. MONTGOMERY. Again, if I understand your question correctly, the private mortgage insurance may go away at 78 percent, but there is a g-fee included in that that is less talked about. So, there is still coverage, but it is something—it is done through what is called a g-fee with the GSEs.

Mr. STEIL. As I understand it, the FHA is supposed to help people obtain sustainable home mortgages by filling a gap in the market for mortgage insurance. As you know, there are several private insurances competing in this marketplace, which we have been discussing.

Can you just kind of elaborate as to how the FHA's premium pricing currently compares to private mortgage insurance and how that competition is playing out, in your eyes?

Mr. MONTGOMERY. Sure. Thank you, Congressman.

It is really almost two different types of coverages you referenced. When theirs falls off, ours stays in place for the life of the loan, provided, obviously, that you are paying the premiums. Theirs is partial coverage and ours is 100 percent.

But I have cautioned that, when making sure that we are available in good times and bad, it is not our goal to supplant private capital and what private mortgage insurers are doing. I think we both perform necessary functions of the mortgage marketplace. I just want to signal that we are not there to compete with them, if you will. But, that said, we want to make sure the borrowers are ready to be borrowers, we have a circumstance that fits our profile, that we are there to help them.

Mr. STEIL. Thank you. I am going to shift gears slightly.

How do you respond to calls to cut premiums or change policies in such a way that would increase the riskiness of FHA's portfolio?

Mr. MONTGOMERY. Do you have a specific example?

Mr. STEIL. Broadly speaking, where these things play out.

Mr. MONTGOMERY. That is part of my comment earlier about, we are a $1.4 trillion corporation, if you will, with a social mission and requirements set forth for us from Congress. That said, we want to make sure that we can help borrowers that need the program.

So, this is something that we look at and deal with every day, what is a delicate balance between risk, defined many different ways; between the right premium structure; between market dynamics, which there is not a lot I can do in that respect. But making sure that we are there when borrowers need us.

I will say this: The technology will help us get to a much better place in terms of looking at data more robustly and faster than we are able to do today.

Mr. STEIL. Thank you very much. I appreciate you being here today, and I yield back the balance of my time.

Mr. MONTGOMERY. Thank you.

Mr. LAWSON. Thank you.

The gentleman from Texas, Mr. Gooden, is now recognized for 5 minutes.

Mr. GOODEN. Thank you. I yield my time to Mr. Stivers of Ohio.

Mr. STIVERS. I thank the gentleman for yielding.

Commissioner, again, thank you so much for being here. I don't think you have gotten a lot of questions about Housing Finance Reform proposals, have you? Did I miss a few questions? Maybe there was one, but there has not been a ton.

I wanted to just tell you I was pleased that HUD had some Housing Finance Reform proposals that you issued earlier this year. They focused their attention on how FHA would continue its mission, although a reformed mission. It did talk about FHA continuing to effectively serve creditworthy, first-time, low-income home buyers, is that correct?

Mr. MONTGOMERY. Yes, sir.

Mr. STIVERS. So, one of the recommendations listed in the report included restructuring FHA as an autonomous government corporation within HUD. Would you be able to expand on talking about how this restructuring would allow FHA to better either address personnel, technology, or contracting issues, which would allow you to continue that mission?

Mr. MONTGOMERY. Thank you very much for the question. Just to be clear, FHA would still be part of HUD and would still report to the HUD Secretary.

Mr. STIVERS. Right, but it would have a little more autonomy.

Mr. MONTGOMERY. It would be a wholly-owned corporation, similar to what Ginnie Mae is. We think the ability to have more—

Mr. STIVERS. Tell us what that would let you do. Help us, help everybody understand the benefits of that.

Mr. MONTGOMERY. I think we would have a little more flexibility in terms of procurement and hiring. We are the largest mortgage insurance entity ever, and we are looking at critical pay, the ability to pay some of our staff more, as well. So, beyond procurement, personnel, we just think having a little more flexibility would be very helpful.

One area that would also be very helpful is to make sure we don't find ourselves in the predicament that we have today in terms of our technology. Obviously, the receipts would still be controlled by this body. But helping ensure that we have some consistent level of funding for our systems would go a long way to help and ensure that we do not have a similar problem to what we are encountering today that we are, of course, desperately trying to fix.

Mr. STIVERS. Thank you for that. I think that would be a helpful way to give you a little more authority and autonomy to do some things, including keeping your technology modern, which we have already talked about. The $20 million down payment on a $100 million problem. I wanted to give you a chance to expand on that a little bit.

Commissioner, I don't know if you have had a chance to review Maxine Waters' Principles for Housing Finance Reform. Have you seen them?

Mr. MONTGOMERY. I have seen parts of them.

Mr. STIVERS. I will lay a few of them out, just so we are all on the same page.

One of her principles is maintaining the the 30-year fixed-rate mortgage option. Is that something you support as a principle?

Mr. MONTGOMERY. Maintaining the 30-year fixed-rate mortgage in the TBA market, yes, absolutely.

Mr. STIVERS. Great. A second one is ensuring there is private capital in place to protect taxpayers. Do you think that is a good idea?

Mr. MONTGOMERY. Yes.

Mr. STIVERS. Another one is providing stability and liquidity so that we can withstand a future financial crisis. Do you think that is a good idea?

Mr. MONTGOMERY. That is something we work on every day.

Mr. STIVERS. Great. And another one is maintaining access for all qualified borrowers so that they can achieve homeownership, the dream of homeownership. Is that something that you agree with?

Mr. MONTGOMERY. Absolutely. We want to make sure that borrowers are ready for homeownership and get the type of mortgage that is appropriate for their circumstance.

Mr. STIVERS. I ask you these questions because I asked them of Mr. Calabria and Secretary Mnuchin and Secretary Carson. They all also agreed with those principles.

The point of bringing this up is that, even though we have not made any progress on housing finance reform since the financial crisis, which was now 11 years ago, there is a lot we all agree on. Chairwoman Waters, you, me, the three principals I spoke about, all agree on those principles.

I think it is time to roll up our sleeves and pursue bipartisan housing finance reform, and I would like to work with you on that. That is the third thing I brought up today I want to work with you on, so I hope we can work together on that. Is that something you would be willing to work with us on?

Mr. MONTGOMERY. Absolutely. And I have never admitted this publically, but I will say it today. That is one of the reasons why I came back.

Mr. STIVERS. Great. I am glad you are here. Thank you for everything you have already done. I am very much looking forward to working with you on many things, including trying to do some real housing finance reform.

Thank you. I yield back.

Mr. MONTGOMERY. Thank you.

Chairman CLAY. I thank the gentleman from Ohio.

I look forward to working with you and the Commissioner on how we get to a place in this country where people can share in the American Dream of homeownership.

At this time, I recognize the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. I thank the chairman and the ranking member for allowing an interloper into the subcommittee's business today. Thank you for that.

Mr. Montgomery, thank you for coming back from FHA. I thank you and Dr. Carson for doing a terrific job representing the taxpayers at HUD.

There has been a lot of talk today about the MMIF fund and its health being well in excess of 2 percent, now over 4 percent. So, congratulations on that.

Philosophically, I hope you will let that capital continue to grow. I remember vividly in the early 2000s in the Bush Administration when the FDIC began to rebate and no longer take deposit insurance premiums, saying that Congress had already capped it. We know how that ended, and we were all asked to pay 3 years of deposit insurance premiums in 2008 in one quarter because of that imprudent decision, alleging the statute only required blank. So, I like seeing a bigger number.

I wanted to start out by asking you, how do you stress test that capital and adequacy number?

Mr. MONTGOMERY. We have a contractor, an actuarial contractor—actually, two of them, and then we have an independent actuarialist who looks at their work, as well. We also have a risk team that works with them. We put them through any number of stress tests.

Mr. HILL. That includes falling housing prices or no appreciation?

Mr. MONTGOMERY. Absolutely. Looking at extreme economic situations.

Mr. HILL. And that includes a discount rate on the net present value of counting future cash flows, which normal people do not do in capital, but you do?

Mr. MONTGOMERY. And that can work both ways as we—

Mr. HILL. Yes, of course it does.

Mr. MONTGOMERY. So, yes, sir. We put it through dozens of different stress tests.

Mr. HILL. Good.

Mr. MONTGOMERY. And those are all available in our annual report.

Mr. HILL. I look forward to studying them in more detail. Is that done annually by the contractor?

Mr. MONTGOMERY. It is, and what we—

Mr. HILL. Is it ongoing, almost quarterly?

Mr. MONTGOMERY. It is ongoing. As we know, the economy changes.

Mr. HILL. Right.

Mr. MONTGOMERY. And we always try to stay ahead of that.

Mr. HILL. Good.

Mr. MONTGOMERY. There is a lot of data out there that helps us, as well.

Mr. HILL. There has been a lot of conversation today about nonbank originators. Now, shockingly, according to Chairman Luetkemeyer, over 80 percent of your originations now—and you talked a lot about false claims today and explained that in detail. I am interested in a different point of view about it, which is the quality of the underwriting between a depository that initiates an FHA loan versus a non-depository. Is there a big difference in the underwriting there?

Mr. MONTGOMERY. I would speak for our criteria, obviously.

Mr. HILL. I understand.

Mr. MONTGOMERY. Ours stays the same. I don't want to speak for depositories or non-depositories as I think they strive to follow our guidelines and stay within the bounds that we require.

Mr. HILL. When you look at your underwriting, which you have up there on the board in front of you, it has been talked about today, but you have seen, as you have said, an increase in a reduction in credit scores and—let's go to the next slide—an increase in debt-to-income ratios pretty substantially.

You referenced a few minutes ago that FHA had looked at residual income tests like the VA has. Is that something you are actively considering?

Mr. MONTGOMERY. It is something we are looking at. I think it has been very helpful for the Veterans Administration, especially the fact that it varies based on region in the country. And, so, it is something that we are looking at.

Again, I just want to stress that DTI, by itself, is not the true indicator, but when coupled with other factors, such as risk layering.

Mr. HILL. When you see them all going up, it causes me some concern. I was glad to see your capital where it was. And I know you have made changes only recently in Fiscal Year 2019, so I understand that. But when I saw all the major indicators of underwriting deteriorating, it certainly got my attention. But I feel like you have covered that today pretty well.

Mr. MONTGOMERY. Yes, sir, and we have a fantastic risk team. We now have brought a retiree over from one of the GSEs, who was a chief risk officer there.

Mr. HILL. Let me shift to one final point, and that is the issue of the Distressed Asset Stabilization Program. Selling assets boosts the MMIF, doesn't it?

Mr. MONTGOMERY. It depends on where they are sold in the process.

Mr. HILL. If you have taken a property back and you are selling it, it is a net contribution?

Mr. MONTGOMERY. Yes. If it goes to real estate owned (REO).

Mr. HILL. Right.

Mr. MONTGOMERY. Note sales, yes, but note sales are a little different than REO sales.

Mr. HILL. But you would not want anything to encumber your ability from distressed sales to build capital, would you?

Mr. MONTGOMERY. I think one thing the previous Administration did and that we have continued to do is to find other alternatives to REO because the carrying costs of those are borne by us. The time that they will sit there is also borne by us. We have contractors we have to pay, certainly. So the ability to use claims without conveyance of title and note sales has been very helpful.

Mr. HILL. It will be interesting. I will follow up with you.

Mr. Chairman, thank you for your indulgence on the time. Thank you.

Chairman CLAY. Thank you. The gentleman yields back.

I would like to thank our witness for his testimony today, and we appreciate you sharing with this subcommittee your thoughts on the future of where we go with the housing policy of this nation.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And now, I will take a point of personal privilege to say congratulations to Mr. Gooden of Texas, or to you and your wife, on the addition of a new family member, your daughter. So, congratulations to you.

Mr. GOODEN. Thank you, Mr. Chairman. I appreciate it very much, and I look forward to bringing her here someday soon to meet you all.

Chairman CLAY. Very good. What is her name?

Mr. GOODEN. Milla Michelle Gooden.

Chairman CLAY. Very good.

Mr. GOODEN. She was born last week.

Chairman CLAY. Congratulations, again.

Mr. GOODEN. Thank you.

Chairman CLAY. This hearing is now adjourned.

[Whereupon, at 4:39 p.m., the hearing was adjourned.]

A P P E N D I X

December 5, 2019

Written Testimony of Brian D. Montgomery
Assistant Secretary for Housing and Federal Housing Commissioner
U.S. Department of Housing and Urban Development

Hearing before the Subcommittee on Housing, Community Development and Insurance
Committee on Financial Services
United States House of Representatives
December 5, 2019

Introduction

Chairman Clay, Ranking Member Stivers, and distinguished members of this Subcommittee, thank you for the invitation to discuss with you the progress and improvements FHA has made recently, the outcomes, and the areas within our programs that we believe warrant further attention. I appreciate the opportunity to provide this Subcommittee an update on our activities at FHA for the first time since being confirmed on May 23, 2018, as the Department of Housing and Urban Development's Federal Housing Commissioner and Assistant Secretary for Housing. I had the distinct honor to serve in this same position between 2005 and 2009, during the Bush Administration and the first six months of the Obama Administration. I also served as acting HUD Secretary under President Obama.

FHA operates the largest mortgage insurance portfolio in the nation, supporting homeownership for more than 8.1 million households, predominantly first-time homebuyers. It also insures loans for multifamily properties that provide affordable housing for American families, as well as hospital and nursing facilities in underserved communities throughout the country.

Since Congress established FHA in 1934 to facilitate the extension of mortgage credit, FHA has insured more than 49.5 million single-family homes across the country. Today, the MMI single-family mortgage insurance portfolio exceeds $1.29 trillion, and when combined with the commercial insurance portfolio – multifamily at $98.7 billion of unpaid principal balance (UPB) and healthcare facilities at $37.2 billion UPB – FHA manages a more than $1.4 trillion portfolio.

Over the past year and a half, FHA has made tremendous strides in improving the financial performance of its insurance programs, mitigating risks within the programs, reducing regulatory burdens, and modernizing its technology platforms. Today, I will update you on FHA's insured mortgage programs as well as other important programs, including property inspection standards, HUD's rental assistance programs, housing counseling, and manufactured housing.

Mutual Mortgage Insurance Fund

On November 14, 2019, HUD released FHA's *FY 2019 Annual Report to Congress Regarding the Status of the Mutual Mortgage Insurance Fund*. The report is a comprehensive summary and assessment of fiscal performance and program outcomes, with current data on loan performance trends and analysis on risk factors covering the single-family portfolio.

FHA's Mutual Mortgage Insurance (MMI) Fund FY 2019 Capital Ratio increased to 4.84 percent from 2.76 percent in FY 2018, which is well above the 2.00 percent statutory minimum. Additionally, MMI Capital (formerly known as economic net worth), for FY 2019 was $62.38 billion, an increase of more than $27.52 billion from FY 2018, and perhaps the highest ever.

A significant amount of the improved condition of the MMI Fund and FHA's financial position can be attributed to the favorable economic environment under President Trump and strong house price appreciation. However, other contributing factors to this progress are the program and policy changes HUD has made in the FHA program to better assess, manage and mitigate risk.

While the improved health of the MMI Fund is welcome news to us all, equally good news is in the number of households served by FHA in FY 2019. I'd like to highlight a few achievements during FY 2019:

- In FY 2019, FHA insured forward mortgages for 990,000 households, of which 616,000 went to first-time homebuyers. FHA insured 31,000 Home Equity Conversion Mortgages (HECM), also known as reverse mortgages.

- FHA remains an important option minority homebuyers. In CY 2018, minorities represented 36.2 percent of all FHA purchase mortgage borrowers, compared to 19.94 percent in conventional lending channels. FHA-insured mortgages were utilized by 40.58 percent of African American households and 37.61 percent of Hispanic households for home purchases.

- As of September 30, 2019, FHA had active insurance on more than 8.1 million forward mortgages totaling more than $1.2 trillion in UPB, and HECMs totaling $64.2 billion in outstanding balance.

Though still negative, HECM MMI capital improved by $7.71 billion, moving from negative $13.63 billion at the end of FY 2018 to negative $5.92 billion at the end of FY 2019. Additionally, the HECM capital ratio improved from negative 18.83 percent in FY 2018 to negative 9.22 percent in FY 2019. This demonstrates, in part, the progress FHA has made toward stabilizing the HECM portfolio's financial drain on the MMI Fund.

While directionally positive, there are underlying trends within the single-family portfolio that FHA must continue to monitor closely. The number of loans with "extreme risk layering" is on the rise. Loans with debt-to-income (DTI) ratios above 50 percent, with credit scores less than 640 and less than 2 months of reserves, continue to rise. From FY 2018 to FY 2019, loans with extreme risk layering increased from 2.4 percent to 2.9 percent of endorsements. This may seem like a small change, but these loans can have a disproportionate impact on overall performance, particularly during economic downcycles. Already FHA is seeing early payment default (EPD) rates creeping up. EPD rates for the FY 2017-19 books of business have more than doubled, to 0.66 percent, from 0.31 percent the FY 2014-16 books. The projected lifetime claim rate for FY 2019 originations, at 9.5 percent, is also higher than any fiscal year since FY 2009, which stands at 12.8 percent. Expected lifetime claims rates are rising because of the increase in higher credit risk characteristics in recent originations. Specifically, the emerging risks that lead to these results include a steady increase in: debt-to-income ratios over 50 percent, the number of loans with credit scores less than 620, and FHA-insured purchase transaction mortgages with some form of downpayment assistance

FHA must continue to strengthen its portfolio if it is to capably fulfill its role as a countercyclical source of mortgage credit, particularly during periods of market distress, and ensure taxpayers are protected from unnecessary risks. In short, our work is not yet done.

Housing Finance Reform

HUD's Housing Finance Reform Plan, submitted to the President on September 5, 2019, proposes a number of recommendations to reduce risks to the MMI Fund, protect taxpayers, and also ensure that FHA maintains its focus on providing access to mortgage financing to low- and moderate-income families who are not served by traditional underwriting. While all the recommendations in HUD's plan are important, I would like to update you on five key priorities: FHA enforcement; modernizing FHA technology; updating FHA's servicing processes and requirements; improving the financial viability of the HECM program; and strengthening FHA's overall risk management framework.

Providing Regulatory Clarity to FHA Lenders

Over the past year, HUD staff have been hard at work on a comprehensive plan to provide clarity on regulatory expectations within the FHA program. Our goal through these efforts is simple – we want to promote the participation of a more diverse lender base, including well-capitalized depository institutions, in FHA's programs. For example, market participants' concerns about uncertain and unanticipated False Claims Act liability for underwriting defects has led many depository lenders to largely withdraw from FHA lending. Today, depository institutions originate less than 14 percent FHA-insured mortgages, down significantly from approximately 43 percent in 2010.

On October 28, 2019, HUD and the Department of Justice (DOJ) signed a Memorandum of Understanding (MOU) concerning the process of deciding when to pursue a claim under the False Claims Act. This MOU provides a framework to apply remedies for FHA lender violations in a consistent, uniform and appropriate way, while establishing clear guidance on the scope of its use.

The MOU is significant because it provides the foundation for cooperation in determining whether to pursue a claim under the FCA. Under the MOU, HUD expects that FHA requirements will be enforced primarily through HUD's administrative proceedings, but the MOU specifically addresses how HUD and DOJ, including the U.S. Attorneys' Offices, will consult with each other regarding use of the False Claims Act in connection with defects on mortgage loans insured by FHA.

HUD is also in the process of revising FHA's annual and loan-level certifications in order to clarify the requirements for compliance by lenders. The proposed revisions would better track statutory requirements and address materiality and culpability considerations.

Finally, HUD has substantially revised FHA's Defect Taxonomy, the document that outlines FHA's method of identifying defects at the loan level. The revisions provide useful data for FHA and lenders by identifying loan-level defects and their sources, causes, and severities through a structured categorization.

Together, these new and revised elements should make affordable FHA-insured mortgages more accessible to qualified borrowers, reduce risks within the FHA program, and preserve appropriately tailored remedies.

Information Technology

A critical concern I shared with Congress during my first time serving as Commissioner, and anyone that would listen in the years that followed, is the need to radically modernize FHA's information technology structure. FHA's single-family business currently runs off 15 different systems, some of which are more than 40 years old. FHA's technological backbone uses an antiquated programming language developed more than a half century ago. Frequent system failures and other technology service breaks result in costly delays, increase FHA risk exposure, as well as that of FHA-approved lenders and other program participants. Considering these factors, HUD is grateful that Congress appropriated an initial $20 million specifically to modernize our Single-Family technology systems in FY 2019 and that both the House and Senate appropriations bills for FY 2020 would provide an additional $20 million. We ultimately need $80-$90 million.

In early 2019, HUD formed an extremely qualified and competent FHA IT Modernization project team that started by gathering business requirements for every element of the loan life cycle from application and origination through claims processing. Working with single family staff at headquarters and in the field, this team has an ultimate objective of fully digitizing FHA's single-family loan cycle.

FHA is actively developing a single technology platform with baseline architecture that includes an end-to-end re-alignment of FHA's single family's IT systems. When complete, this platform will:

- Provide lenders with a single portal to conduct business from loan application through claims processing, if necessary; and
- Allow for electronic submission and management of documents to reduce reliance on paper and improve processing speed.

The data analysis facilitated by these technology modernization projects will be transformative to our ability to better protect the soundness of the MMI Fund, while simultaneously improving FHA's ability to more efficiently and cost effectively insure mortgages for harder to serve yet creditworthy borrowers.

Servicing

Improving FHA's single-family default servicing processes is a priority for HUD. The Department is focused on reducing the burden of servicing FHA loans, aligning servicing requirements with the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, where possible, and ensuring FHA's loss mitigation options protect taxpayers and promote sustainable home ownership.

FHA's recent Mortgagee Letter (ML) 2019-14, *Updates to FHA's Loss Mitigation Options for Borrowers in Presidentially Declared Major Disaster Areas (PDMDAs)*, is a good example of how HUD is helping execute and achieve better outcomes for everyone – borrowers, servicers, and taxpayers. ML 2019-14 provides expanded foreclosure prevention options to allow borrowers with FHA-insured mortgages greater ease in curing delinquencies, while protecting the MMI Fund. FHA's "Disaster Standalone Partial Claim" – implemented last year to assist homeowners impacted by 2017 natural disasters – will now be a standard mortgage relief option available for all survivors of major disaster. This option permits many homeowners to resume making payments without modifying their loan or re-amortizing the loan term, avoiding both the foreclosure process and payment increases. It also streamlines income documentation and other requirements to expedite relief.

Within the larger umbrella of "loss mitigation," FHA is working to streamline its application process for loan modifications and the options available to borrowers to better align them with the GSEs. This means making the milestones for servicers trying to help troubled borrowers less rigid, ensuring the system of curtailment of interest and expenses are commensurate with any harm done, and taking into account market conditions.

FHA is also working to reduce burdens in the conveyance process. These conveyance policies can have a direct impact on participation by lenders and therefore a significant impact on access to FHA products by our traditional borrowers.

Reverse Mortgages

The HECM program's financial footing is significantly more stable today, but remains far short of the Department's objectives. To further improve the fiscal soundness and viability of the HECM program, FHA published ML 2019-16, *Home Equity Conversion Mortgage (HECM) Program – Continuation of HECM Collateral Risk Assessment Requirements*. Through this ML, FHA made permanent its HECM collateral risk assessment policy first announced in 2018. This policy addresses inflated property appraisals by requiring a second appraisal when FHA determines that the first appraisal needs additional support. Our analysis estimates a reduction of approximately $200 million in insured volume/risk exposure from implementation of this ML.

FHA also recently published ML 2019-15, *Updates to the Mortgagee Optional Election (MOE) Assignment for Home Equity Conversion Mortgages (HECMs),* which provides more guidance for HECMs related to non-borrowing spouses, as well as to the heirs of the last surviving HECM borrower, and both clarifies and streamlines Servicer responsibilities in the assignment process.

FHA Risk Management

During FY 2019, FHA made changes to its Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard to better account for emerging default risk indicators. TOTAL is an evaluation tool that assesses a borrower's credit history and application information. To address concerns associated with the increase in the concentration of mortgages with high DTI ratios, these adjustments to TOTAL will require more mortgages with a combination of higher-risk characteristics to undergo a manual underwriting process which subjects applications to greater scrutiny.

To address the 250 percent growth in cash-out refinances from FY 2013 to FY 2018, and to better manage this risk, FHA published a Mortgagee Letter to reduce its maximum Loan To Value and combined LTV percentages for cash-out refinance mortgages from 85 percent to 80 percent. This new policy aligns with the GSEs' policy regarding maximum LTV/CLTV percentages.

Multifamily Housing

The Office of Multifamily Housing Programs provides mortgage insurance to approved lenders in order to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily rental housing projects. FHA's Multifamily mortgage insurance endorsement program is part of FHA's General Insurance and Special Risk Insurance (GI/SRI) Funds. Multifamily insurance programs are funded through mortgage insurance premiums paid by borrowers at the time of endorsement and periodic payments thereafter.

The multifamily mortgage insurance programs endorsed 691 new multifamily loans totaling $11.4 billion in FY 2019, bringing the current managed/insured portfolio to 11,512 loans with an UPB of $98.7 billion. FHA's Office of Multifamily Programs maintained a low default rate of 0.08 percent in FY 2019.

This Office also oversees HUD's Rental Assistance Demonstration program, which allows Public Housing Authorities (PHAs) and private apartment owners of other HUD-assisted properties to leverage the private market to make capital improvements and preserve properties for long-term affordability. The program converts units from their original regulatory platform to project-based Section 8 contracts. In FY 2019 RAD converted and preserved 17,104 units, increasing the total preservation outcome to more than 118,822 units since program inception.

FHA's Office of Multifamily also provides asset oversight on a combined portfolio serving 2.6 million insured and assisted rental households for a total of 30,206 properties; the majority of the assisted units include Project Based Section 8 and HUD's Section 811 and 202 properties serving extremely low- and very low- income seniors and people with disabilities.

REAC/NSPIRE

On August 21, 2019, HUD formally announced a new demonstration to test innovative new approaches for making certain that thousands of public housing agencies (PHAs) and private owners provide housing that is safe and habitable. The new National Standards for the Physical Inspection of Real Estate (NSPIRE) is intended to replace the inspection process used by HUD's Real Estate Assessment Center (REAC) – the Uniform Physical Conditions Standards (UPCS) – which has not seen major changes in more than 20 years. UPCS was effective when created but it has not kept pace with changes across the various programs and evolving industry property management practices and technology.

A HUD intra-agency task force developed NSPIRE and has sought the input of stakeholders – including PHAs, owners, advocacy organizations and residents – to make refinements. The goal was to design a new simplified inspection system that more accurately reflects the physical conditions within housing units and to place a greater emphasis on the health and safety of HUD residents.

Office of Healthcare Programs

The Office of Healthcare Programs administers FHA's programs that provide mortgage insurance to residential care facilities and hospitals under Section 232 and Section 242. In FY 2019, FHA issued 314 commitments totaling $4.2 billion in residential care facility financing, growing the combined insured healthcare portfolio to approximately $37 billion, with a loan count surpassing 3,800. The claims rates for FY 2019 in the Section 232 program was 0.29 percent. There were no claims in the Section 242 program during FY 2019. The Office of Healthcare mitigates risk to FHA through its strict underwriting process, and asset management and loss prevention strategies that reduce claim payments through modifications, note re-assignments, and the identification of equity providers and purchasers.

Office of Housing Counseling

Through the first three quarters of FY 2019, the Office of Housing Counseling, through its network of HUD-approved Housing Counseling Agencies, provided education and tools to approximately 800,000 households – homebuyers, homeowners, renters, and disaster victims – so they can make responsible choices to address their housing needs.

HUD awarded $42.8 million in housing counseling grants to 207 national, regional, and local organizations to help families and individuals with their housing needs and to prevent foreclosures.

The counseling advice supported by HUD can relate to property maintenance, financial management and literacy, and other matters to assist clients in improving their housing conditions, meeting their financial responsibilities, and fulfilling the responsibilities of tenancy or homeownership. In addition to providing counseling to homeowners and renters, these organizations assist homeless persons in finding the transitional housing they need to move toward a permanent place to live. Finally, grantees also assist senior citizens seeking reverse mortgages. These agencies provide counseling for the rapidly growing number of elderly homeowners who seek to access equity in their homes while preserving their ability to age in place.

Office of Manufactured Housing Programs

Manufactured housing plays a vital role in meeting the nation's affordable housing needs, providing 5.5 percent of single-family housing starts in 2017. More than 22 million Americans reside in manufactured housing, with a median family income of $33,000.

HUD's Office of Manufactured Housing has been deeply engaged in the Administration's efforts to identify and remove unduly burdensome regulations while assuring that newly-constructed manufactured homes continue to meet the statutory goals of quality, safety, durability, and affordability. In March, HUD published a proposed rule on formaldehyde emissions. This rule would enable HUD to better align with the Environmental Protection Agency in regulation of wood products containing formaldehyde and eliminate the requirement that a health notice be posted in each manufactured home. HUD is working to finalize this Formaldehyde Rule.

HUD is currently processing the third set of construction and safety standards, which are expected to be published as a proposed rule before the end of the calendar year. This set of standards proposes to address carbon monoxide detection, stairways, fire safety considerations for attached garages, draft stops, and venting systems. Close behind the third set of standards, HUD is working to combine the fourth and fifth sets of standards for processing and publication. HUD is improving its internal process to better ensure regular, timely updates to the standards to keep pace with industry changes.

In 2018, HUD announced a top-to-bottom review of its manufactured housing policies. The Department invited the public to comment on policies and assess compliance costs of the program against the backdrop of HUD's goal to facilitate affordable housing. HUD's Manufactured Housing Consensus Committee convened in Washington from October 29-31, 2019, and completed its review of over 300 deregulatory comments and log items, which will inform updates to HUD standards and foster affordability in manufactured housing.

Conclusion

I thank this Subcommittee for inviting me here today to discuss the status of operations across FHA's various mortgage insurance portfolios and program areas. We are optimistic about the future of FHA and, while we are not celebrating yet, FHA's future is looking much brighter. However, I cannot overstate that there is a lot of hard work remaining. I look forward to working with Congress to address these challenges and ensure that FHA continues to effectively serve its customers and fulfills its fiduciary duty to taxpayers.

AIME
ASSOCIATION OF INDEPENDENT MORTGAGE EXPERTS

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December 2, 2019

The Honorable William Lacy Clay
The Honorable Steven E. Stivers
U.S. House Committee on Financial Services
Subcommittee on Housing, Community Development and Insurance
2129 Rayburn House Office Building
Washington, DC 20410

Re: Subcommittee hearing entitled, "An Examination of the Federal Housing Administration and its Impact on Homeownership in America."

Dear Chairman Clay and Ranking Member Stivers:

Thank you for holding a hearing on the Department of Housing and Urban Development's (HUD) Housing Finance Reform Plan (Plan). The Association of Independent Mortgage Experts (AIME), is a non-profit national trade association created for independent mortgage brokers who play a critical role in ensuring home purchase and refinancing mortgages for the middle class, low- and moderate-income homeowners, including minority and rural households, veterans and many in underserved communities.

AIME is supportive of a number of FHA managerial improvements included in the Plan, including more flexible pay scales for FHA and Ginnie Mae employees to attract talented employees and modernizing its outdated information technology (IT) systems.

AIME is also sympathetic to FHA concerns about the financial impact of Down Payment Assistance Programs (DPA) and Property Assessed Clean Energy (PACE) loans and would support appropriate changes to reduce risk in those areas, or other loan types, such as reverse mortgage loans, where there is demonstrable evidence of excessive risk.

Any actions, however, to reduce FHA loan availability should not be based on an arbitrary objective of reducing the government footprint but should instead be based only on clear evidence of excessive risk for such types of loans. In addition, any such plan should consider its impact on home ownership, which has trended lower since the adoption of Dodd Frank.

As you know, the Plan explicitly advocates that we should "Refocus FHA to its Core Mission" by "Targeting Programs to Borrowers not Served by Traditional Underwriting." As noted, this includes elimination or reduction of a number of different types of loans, including repeat borrowers or different types of refinance products.

It is true that FHA's role has traditionally been to serve borrowers not well served by other mortgage sources. This process, however, has generally worked by self-selection; FHA loans can be more costly than conventional or bank loans, and therefore borrowers that can obtain a conventional or bank loan do so, while those that cannot generally gravitate to FHA. A variation on this conclusion is that FHA generally offers lower down payment requirements than other mortgage options and therefore some borrowers that could obtain other types of loans use FHA for this reason.

Therefore, it does not make sense to arbitrarily roll back the role of FHA in mortgage credit, due to either the goal of reducing FHA's footprint or trying to shift loans from FHA to Fannie and Freddie or to banks or other so-called "private capital."

AIME believes that we should preserve the availability of Federal Housing Administration (FHA), Veterans Administration (VA), and Rural Housing Service (RHS) single-family mortgage loans and reject efforts to shrink their footprint. As many private lending sources exited the mortgage market after the 2008 housing crisis, FHA, VA, and other agency mortgage programs stepped up to maintain liquidity in the mortgage market and support the economy. While it is a laudable goal to have more private lenders return to the market, there is no guarantee that this private market will backstop any of the proposed reductions. This is especially true, given the specter of the expiration of the QM patch in early 2021. FHA, VA, and RHS loans should not be reduced in order to arbitrarily shrink their footprint, and this is clearly not the time to do so. Instead, reductions in loan availability should only be made for the types of loans that have demonstrated levels of excessive risk.

FHA has for 80 years maintained a strong financial track record because it has a mix of borrowers, by income and credit quality. This approach should not be abandoned.

Thank you for your consideration of our views, and we look forward to working with you and the committee to make sure that everyone can partake in the American dream of homeownership.

Sincerely,

Anthony Casa, Chairman
Association of Independent Mortgage Experts

National Mortgage News Opinion FHA's strong financial showing points the way on policy

By Anthony Kellum
Published December 03 2019, 11 : 03am EST

Last month HUD published its annual FHA Actuarial Report. The report shows extremely strong financial performance — with reserves against losses of $62 billion and an economic net worth-capital ratio of 4.84% for the overall portfolio. The FHA's capital ratio is the highest since 2007 and almost two and a half times the FHA's statutory capital requirement.

This reflects the solid job the FHA is doing in meeting its dual statutory requirements to facilitate access to mortgage credit for first-time homebuyers, underserved and minority borrowers, while protecting taxpayers through prudential financial management.

During the 2008 financial crisis, when private capital all but disappeared from the mortgage market, the FHA continued insuring loans to qualified homebuyers, stabilizing the housing market.

Doing so stressed FHA insurance reserves. However, prudent program management — including significant premium hikes to balance the increased risk of loss from market uncertainty — allowed the FHA to ensure a steady flow of mortgage financing at the same time Fannie and Freddie fell into conservatorship and the Federal Reserve Banks and Treasury advanced trillions to save banks, AIG and others.

The economic rebound and related home appreciation have pushed FHA reserves to record levels — culminating in last week's strong actuarial report. The

FHA's financial metrics — measured by historically low default and foreclosure rates and relatively high average FICO scores — are also very strong.

So where do we go next? The Community Home Lenders Association, anticipating a strong actuarial report, recently wrote a letter to FHA suggesting the proper course and responding to the administration's recent housing finance plan.

The CHLA's letter cited its support of FHA managerial improvements outlined in the plan, including more flexible pay scales for the FHA, modernizing IT, and better aligning servicer penalties for errors with their financial impact. The CHLA also expressed concern about certain loan types such as down payment assistance programs and PACE loans.

However, the CHLA letter forcefully pushed back against proposals in the plan to: (1) limit FHA loans to borrowers not served by conventional underwriting, (2) eliminate FHA loans for repeat borrowers and for conventional to FHA refinances and (3) reduce availability of cash-out refis.

The second obvious conclusion from the Actuarial Report is the FHA needs to continue the process it started in 2015 to terminate temporary premium increases put in place to shore up the FHA fund during the Great Recession. Reversal of the 2013 policy change to require mortgage insurance for the life of the loan should be the next step in this process.

Current life of loan premiums significantly overcharge FHA borrowers — largely low- and moderate-, minority and first-time homebuyers — who, by the time they reach the 78% LTV threshold, have already paid around 10% of the loan amount in premiums. The life of loan policy also accelerates Ginnie Mae prepayment speeds — a source of concern to that agency, reducing the prices of Ginnie securities that ensure borrowers receive affordable interest rates.

Some argue we can't afford to lose the revenue from eliminating life of loan insurance. We heard the same type of argument four years ago when many groups argued against a premium cut; yet the FHA insurance fund continues to get stronger.

Based on observations of the borrowers Kellum Mortgage and other CHLA members serve, we believe the life of loan policy could actually reduce FHA revenue, because borrowers refinance into conventional mortgages as soon as they can, knowing they pay 30 years of premiums under the FHA. This causes the FHA to lose premiums from these borrowers.

Influential organizations spanning the political spectrum — including the National Association of Realtors, the National Association of Real Estate Brokers, the National Association of Hispanic Real Estate Professionals, the National Community Reinvestment Coalition, the National Housing Conference and the National Consumer Law Center — support the effort to end life of loan premiums. Now, with the Actuarial Report in hand, it is time for the FHA to act to end this policy.

Given the critical access to credit role the FHA plays today, and in light of its strong financial performance, now is not the time to "reduce the FHA's footprint." My firm deals with working-class families all the time, and I can attest that FHA underwriting standards are still prudent when applied properly and the FHA is sorely needed in the marketplace.

The FHA's core mission is to provide affordable mortgage credit to borrowers not served by traditional underwriting — not to deny families affordable mortgage credit to entice the private market to do so. As the FHA program has proven highly profitable, clearly something other than profits is keeping the private market from offering alternatives to the FHA program. We should figure that out before limiting hard-working families' ability to own homes.

The FHA has played a critical role in providing access to credit without taxpayer risk. Let's keep it strong and effective.

Anthony Kellum is president of Kellum Capital Group and Kellum Mortgage, a division of Local Lending Group, based in Roseville, Mich.

House Committee on Financial Services

Hearing: **An Examination of the Federal Housing Administration and Its Impact on Homeownership in America**

December 5, 2019

U.S. Representative Blaine Luetkemeyer (MO-03)

Question #1

Mr. Montgomery, in recent years, Fannie Mae and Freddie Mac have distributed much of their credit risk through various risk-transfer transactions, including sharing risk with lenders, mortgage insurers and reinsurance markets. This approach has, simultaneously, reduced risks for taxpayers and developed broad and liquid markets for mortgage credit risk. The FHA has yet to develop a similar credit risk transfer program despite holding a substantial amount of risk on its books. Is the FHA currently exploring ways to collaborate with sources of private capital to engage in risk sharing and reduce the government's exposure to single family mortgage credit risk? Does FHA have existing authority to enter into risk-sharing arrangements or does Congress need to act?

Answer: FHA is currently exploring ways to collaborate with sources of private capital to engage in risk sharing.

It is the Department's understanding that the efforts of other federal government programs engaged in risk transfer transactions with the reinsurance industry (e.g., Export-Import Bank and Federal Emergency Management Agency) were facilitated by special Congressional mandates.

U.S. Representative Joyce Beatty (OH-03)

Question #1

Earlier this year, the U.S. House of Representatives unanimously passed my bill, H.R. 2162, Housing Financial Literacy Act of 2019 on the floor. This bill would give a 25-basis point discount on a first-time homebuyer's FHA upfront mortgage insurance premium for taking a pre-purchase housing counseling course. This bill could lower the down payment of a first-time homebuyer by $500, on average, in addition to lowering the default rate within the Mutual Mortgage Insurance Program.

Under current law, the FHA has the authority to implement this program, which it did so from 1996-2000.

Would you consider re-implementing this discount for first-time homebuyers who take pre-purchase housing counseling classes? Why or why not?

Do you believe that first-time homebuyers who receive pre-purchase housing classes are less likely to default on their FHA loans? Why or why not?

Answer: Pre-purchase counseling programs have been available to borrowers for over 30 years. Over that time, studies have been unable to document the substantial improvement in credit performance necessary to justify a fee reduction. The first large-scale, HUD-sponsored study of the benefits of counseling for first-time homebuyers is underway. The results of the "First-Time Homebuyer Education and Counseling Demonstration" will help inform whether a premium discount for such borrowers is justified.

In 2016, the U.S. Department of Housing and Urban Development's Office of Policy Development and Research released parts one and two of a series of reports on "The First-Time Homebuyer Education and Counseling Demonstration." The initial report published in 2016 stated that the final report was expected to be released in 2020.

1. When do you expect this final report to be released?

Answer: The results of the study will likely be available toward the end of FY2021.

Question #2

Americans owe more than 1.6 trillion in student loan debt, which the Fed says has contributed to the overall decline in homeownership among our younger population. The FHA's standard for calculating a potential homebuyer's student loan payment is not actually based on how much they pay per month, however. It is based on 1% of the total amount they owe. This arbitrary standard hamstrings the ability of those with student debt from achieving the American Dream of homeownership.

1. Will this Administration consider changing this standard? If not, why not?

Answer: FHA consistently monitors its policies to ensure the appropriate balance is made between promoting homeownership opportunities for low-to-moderate-income and first-time homebuyers while simultaneously protecting taxpayers against risk. As such, FHA will take a broad approach in reviewing this policy in conjunction with the overall mission and risk posed to the FHA insurance fund.

2. Is this method for calculating student loan debt based on sound underwriting standards? According to your knowledge, is there a similar method being used in the private sector?

Answer: FHA requirements for the calculation of student loan debt provide that either the actual payment (provided such payment fully amortizes the loan) or the greater of 1 percent of the balance or the payment amount shown on the credit report be used.

This policy enables consideration for the increase in payments that would be associated with payment terms that provide for negative amortization.

The 1 percent standard applied by FHA approximates the payment associated with a fully amortizing loan. For example, the monthly payment for the average student loan of $30,000 with a 10-year term and 5 percent fixed rate would be $324 compared with $300 applying the "1 percent rule."

At the time FHA implemented this requirement, this standard was the most predominantly used by the industry. Since that time, there have been changes made by many participants, but no one single standard has dominated.

Question #3

In FHA's most recent report to Congress on the financial status of the Mutual Mortgage Insurance Fund (MMIF), they reported that the MMIF had a capital ratio 4.84 , well above its mandate of 2.00%. The capital ratio for the forward mortgage portfolio, which is overwhelming used by first-time homebuyers and minority households to achieve the American Dream of homeownership, was 5.44%. While the capital ratio for the reverse mortgage portfolio was negative 9.22%.

Back in January 2017, I wrote to Secretary Carson urging him to follow through on the previous Administration's decision to lower mortgage insurance premiums for FHA loans, which would lower the costs of mortgage insurance for FHA borrowers. This could have saved borrowers roughly $500-$700 a year. As we know, Secretary Carson overturned the Obama Administration decision, citing the financial status of the MMIF.

1. What is the process FHA utilizes in determining when is the appropriate time to raise or lower upfront mortgage insurance premiums and annual mortgage insurance premiums?

Answer: As stated in HUD's Housing Finance Reform plan, the Department is committed to a sound, risk-based capital regime for the MMIF, well above the two percent capital ratio, which will manage risk exposure to defined stress scenarios. This will ensure FHA can weather stress events without requiring a taxpayer bailout, and is not inappropriately competing with the GSEs or fully private capital.

2. If 4.84% is not a high enough capital ratio for lowering either the upfront mortgage insurance premium or annual mortgage insurance premium, what is the capital ratio needed to justify such a decision?

Answer: Prudent management practices should overlay the statutory capital requirement, with a risk management approach that considers the health of the economy and the sensitivity of the fund to unexpected economic changes. Although the progress made in building up capital to its present levels is encouraging, recent history has shown that reliance on a single metric can be a misleading indicator of the Fund's health. For example, the MMI capital ratio reached 7 percent in 2007, yet fell to 0.4 percent in 2009, just 2 years later.

3. In 2000, FHA reduced the upfront mortgage insurance premium on FHA loans from 1.75%to 1.5%, citing the strength of the MMIF, which at the time had a capital ratio of 3.51%. The current upfront mortgage insurance premium is 1.75%, the same as it was in 2000. The current capital ratio of the MMIF is 4.84%, which is greater than it was in 2000. Why was it appropriate to lower upfront mortgage insurance rates in 2000, but it is not appropriate to lower them in 2019?

Answer: FHA's current MIP structure balances the need to prudently manage risks on behalf of the U.S. taxpayer while supporting FHA's mission to promote access to sustainable mortgage credit for qualified first-time, low and moderate-income homebuyers.

The premium reduction in 2000 was not appropriate. FHA underpriced default risk earlier in the decade, which became apparent only in retrospect. The current structure now covers long-term credit risk exposure, while contributing a modest amount to MMI Capital for both forward and HECM mortgages as a "cushion" against future stress events.

4. Are borrowers who receive a 30-year mortgage from FHA effectively subsidizing the FHA's reverse mortgage program?

Answer: To date, because both the forward and reverse FHA products are included in the Mutual Mortgage Insurance Fund, net revenue from the forward product has cross-subsidized the reverse product portfolio.

5. Should Congress and HUD consider separating the two funds?

Answer: In its Housing Finance Reform plan, HUD recommends that Congress set a separate HECM capital reserve ratio and remove HECMs as obligations to the MMIF. This would provide for more transparent accounting of program costs and prevent cross-subsidization that has occurred with mission borrowers in the forward mortgage portfolio.

U.S. Representative Steve Stivers (OH-15)

Question #1

Commissioner Montgomery, the September 2019 Treasury and HUD reports on housing finance reform recommend the federal housing agencies, including the FHA, evaluate refinancing product activities within their portfolios, and potentially restrict certain products including cash-out refinances.

As you know we are in a low interest rate environment, which may provide substantial borrower savings for individuals who choose to refinance. Furthermore, cash-refinancing is an important source of investment liquidity for Americans across the country and I have heard concerns that limiting refinances within FHA may impact borrower benefits.

With this in mind, do you believe appropriate restrictions are already in place to prevent unnecessary refinancings? And do you believe these restrictions are sufficient to protect the mortgage insurance fund? Additionally, does the FHA plan to conduct an impact assessment on borrowers and the Mutual Mortgage Insurance Fund of such a policy change

Answer: In 2019, underwriting changes were implemented to put FHA on equal footing with Fannie Mae and Freddie Mac guidelines on cash-out refinances. Qualified FHA borrowers are still permitted to convert a portion of the equity in their homes into liquid assets.

Prior to the change, a significant share of FHA's cash-out volume came from GSE borrowers, which increased FHA's footprint and risk to the government's balance sheet. Aligning FHA policies with the GSE guidelines removed that incentive. As indicated in the HUD Housing Finance Reform Plan, FHA is monitoring its cash-out refinances closely to determine whether further action is necessary.

Question #2

As you know, the FHA government insurance program has a "life of loan" coverage, meaning the mortgage is insured for as long as the borrower is in the home with that FHA-insured loan.

There is some talk from my friends on the other side of the aisle to cancel the annual MIP, or mortgage insurance premium, collected for FHA loans, once the loan to value reaches 78% of the original sales price or appraised value. Remember, if the premiums were to stop, that loan is still insured by the government for the "life of the loan." So, why would it make sense for taxpayers to remain "on risk" and not be compensated? Again, I commend you for the health of the MMIF now, but I think to maintain that in downturns premiums should continue to be paid as the coverage stays with the loan.

Answer: *Private* mortgage insurers (MIs) are required to automatically terminate coverage once a loan amortizes to 78 percent. Once a policy is cancelled, MIs are no longer responsible for losses, as the credit risk shifts to Fannie and Freddie Mac, which continue to charge their guarantee fee for the life of the loan. In contrast, FHA continues to be responsible for all mortgage credit losses after MIP payments are cancelled.

Critics of FHA's "Life of Loan" policy incorrectly assert that loans that have amortized to 78 percent present little risk to FHA and the Mutual Mortgage Insurance Fund (MMIF).

The table below shows how many years are required for a loan with an original LTV of 96.5 percent to amortize to 78 percent LTV at various interest rates. Also shown are the corresponding share of FHA claims that would remain post-cancellation based on FHA modeling that draws on over 30 years of historical loan performance. The table below indicates that approximately 20 percent of MMIF claims are projected to occur in loans originated before 2010. The data does not include the heavy losses FHA has already incurred in recent years for 2005 through 2008 vintages that were seasoned for well over 9 years when they ultimately resulted in a claim.

Mortgage coupon	Years to 78%	Projected claims remaining
3.0%	8	25%
4.0%	9	20%
5.0%	10	16%
6.0%	11	12%
7.0%	12	10%

On a preliminary basis, FHA estimates that cancellation of the annual MIP at 78 amortization would reduce contributions to the MMIF by approximately $1.7 billion for each year of production. FHA would need to raise its annual MIP by 0.10 percent to 0.15 percent to replace lost revenue.

U.S. Representative Velazquez (NY-12)

Question 1:

Mr. Montgomery back in June you told the *Caribbean Business*, that HUD still needed to publish a federal register notice for all states getting CDBG-DR money, including Puerto Rico. As of Sept 4th, HUD published all notices expect for Puerto Rico's. Why did HUD not publish Puerto Rico's notice? Did someone from the White House or anyone else at HUD directly instructed you not to publish this notice? When can we expect to HUD to begin complying with the law and publish the notice for Puerto Rico?

Answer: On January 27, 2020, HUD published the Mitigation Notice for the Commonwealth of Puerto Rico in the *Federal Register*. Also, on January 15, 2020, the Department issued the second CDBG-DR grant agreement that will govern $8.2 billion for unmet needs in Puerto Rico. The grant agreement will make $1.7 billion available to the Commonwealth and contains requirements consistent with those in the Notice for mitigation funds.

The Mitigation Notice was originally scheduled to be released in September 2019, but the Department delayed publication after the unprecedented political unrest that occurred in Puerto Rico in August. That instability led to the Commonwealth having three governors in the span of less than a week as well as uncertainty over the continued leadership of HUD's grantee, the Puerto Rico Department of Housing (Vivienda). In late August, the Department was also advised by HUD's Office of Inspector General of an ongoing audit of Vivienda's financial capacity, which identified significant weaknesses with that agency's procurement controls.

HUD has now appointed a Federal Financial Monitor to oversee the disbursement of all HUD disaster recovery funds in Puerto Rico and the U.S. Virgin Islands. The Federal Financial Monitor, coupled with the new, improved financial controls, will help ensure recovery funds get to the people who need them the most while also protecting the taxpayers.

Question #2

Commissioner Montgomery, the Federal Financing Bank and Risk Sharing Program was a hugely successful partnership between Treasury, HUD, and state and local housing finance agencies that helped construct more than 3,000 units of affordable housing in New York City and 20,000 units nationwide. In September 2018, I lead a letter on behalf of the New York City Congressional Delegation to Secretary Carson urging HUD and Treasury to extend the program, but, after a short extension period, the program officially expired at the end of 2018. Can you explain why Treasury and HUD canceled this highly successful program?

- **Follow-up:** Has there been any discussion amongst the two departments about reviving the program?

Answer: The FFB Risk Sharing Initiative was designed and announced as a temporary program to be utilized until such time as tax-exempt bond financing rates recovered from the financial crisis. Tax-exempt bond rates have recovered substantially, and Housing Finance Agencies (HFAs) now have access to competitively priced capital. Considering this positive change in the bond markets, the FFB/RS Initiative was scheduled to cease accepting new applications for commitments from HFAs on September 30, 2018.

On September 28, 2018, FHA announced a short-term extension of the FFB/RS Initiative for eligible HFAs up to December 31, 2018, thereby allowing the acceptance of additional applications for commitments through the end of that year. Projects with a firm commitment have until September 30, 2021 the expiration of the Program Financing Agreement, to complete their financing closing.

The program was not extended past December 31, 2018, because the Treasury and HUD determined that under current economic conditions, a federal alternative to tax-exempt bond financing was no longer necessary.