



**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410**

**Written Testimony of Carol Galante
Assistant Secretary for Housing/Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development (HUD)**

**Hearing before the Senate Committee on Appropriations
Subcommittee on Transportation, Housing and Urban Development, and Related Agencies**

**“Federal Housing Administration’s Fiscal Year 2014 Budget Request”
Tuesday, June 4, 2013**

Thank you, Chairman Murray and Ranking Member Collins, for this opportunity to discuss how HUD’s fiscal year 2014 budget proposal will grow our economy from the middle class out—not from the top down—while supporting the recovery in our housing market and economy.

As the President has said, housing is an important part of our economic recovery. In 2012, rising home values lifted 1.7 million families back above water and created \$1.6 trillion in equity. New home construction levels are at their highest since before the financial crisis and new home purchases are up 12 percent over last year. The number of new foreclosure actions has been cut in half since the height of the crisis. And FHA has played a critical role in ensuring that we remain on the path to a complete recovery.

This budget provides FHA with the ability to assist HUD in meeting three goals that are critical to the Agency’s mission. Using a variety of strategies, it allows us to focus on strengthening the nation’s housing market to support the economy while also protecting consumers. And, despite the challenging fiscal climate, this budget allows us to meet the need for quality, affordable rental homes across the nation. Finally, this budget continues our efforts to transform the way HUD does business – creating a more modern, efficient, and responsive agency.

Strengthen the Nation’s Housing Market to Bolster the Economy and Protect Consumers

This Administration entered office confronting the worst economic crisis since the Great Depression—with mortgages sold to people who couldn’t afford or understand them, while banks packaged them into complex securities on which they placed huge bets. And while this crisis was largely market driven, the American people have turned to Congress and the Administration for leadership and action in righting our nation’s housing market. HUD remains firmly committed to working together with communities and individuals to cope with the unprecedented challenges facing the housing market.

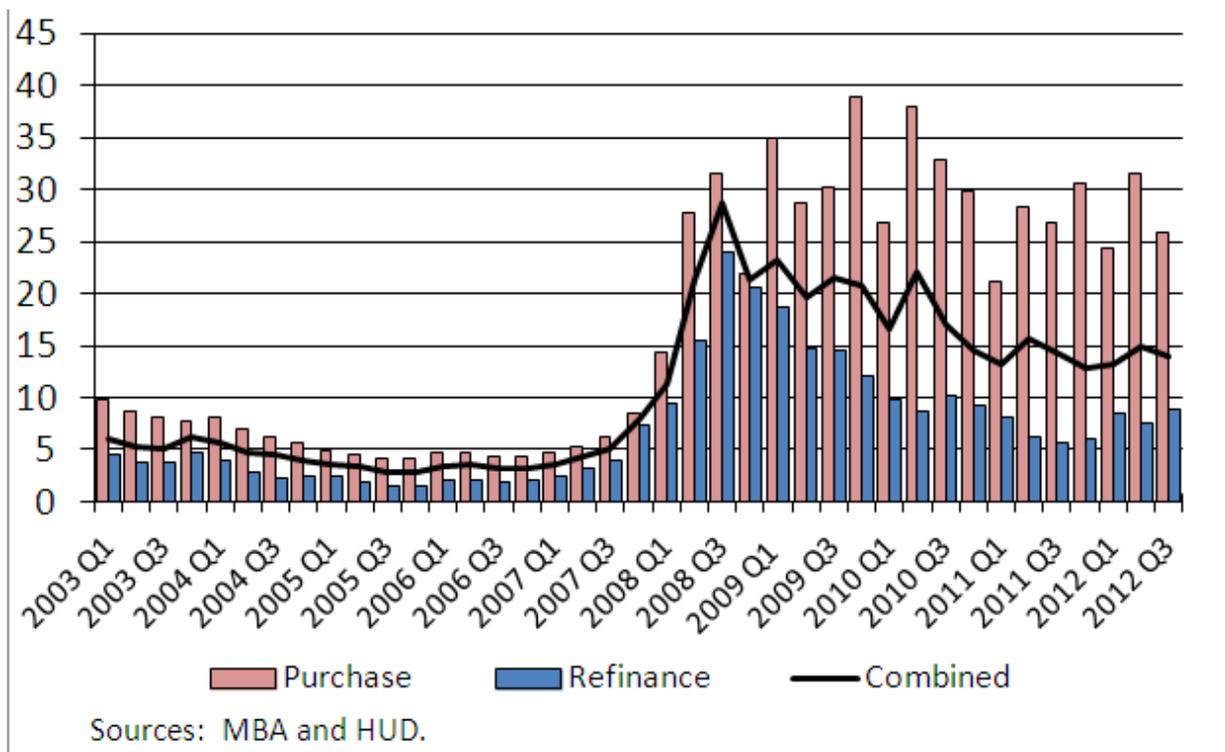
Responding to the Market Disruptions and Serving Underserved Populations

The Federal Housing Administration (FHA), along with the Government National Mortgage Association (GNMA), continues to have a significant impact on the nation’s economic recovery. The activities of the Federal Government are critical to both supporting the housing market in the short term and providing access to homeownership opportunities over the long term, and doing both in a way that minimizes risks to taxpayers.

For FY 2014, HUD is requesting \$400 billion in loan commitment authority for the Mutual Mortgage Insurance Fund, which will provide an estimated 1.2 million single-family mortgages – at a projected \$199.3 billion in loan volume for forward and reverse mortgage loans as well as loans insured under the FHA Short Refinance program for borrowers in negative equity positions. HUD is also requesting \$30 billion in loan guarantee authority for the General and Special Risk Insurance Fund, which will provide an estimated 273,000 units in multifamily housing properties and an estimated 75,700 beds in healthcare facilities. The need for this investment is clear as FHA continues to play an important countercyclical role that has offered stability and liquidity throughout the recession. While a recovery of the housing market is currently underway, FHA continues to act as a crucial stabilizing element in the market, by assuring ongoing access to credit for qualified first-time, low-wealth or otherwise underserved borrowers. However, FHA’s expanded role is and should be temporary.

FHA’s share of the single family mortgage market (purchase and refinance transactions) has gone from a low of 3.1 percent of loan originations in 2005, up to a peak of 21.1 percent in 2010, and more recently down to 13.9 percent in the 3rd quarter of 2012 (U.S. Housing Market Conditions Report, 3rd Quarter 2012). In fact, the number of FHA single family loan endorsements by loan count, has declined to levels comparable to those seen in fiscal years 2002 and 2003, when FHA’s market share was lower than it is today, indicating that FHA’s current market share is primarily due to a substantial decrease in the size of the total mortgage market rather than exceptionally high FHA loan volumes. As the market continues to recover and private capital returns at more normal levels, FHA’s role will naturally recede and FHA has demonstrated that it is committed to policies that facilitate this return. However, during this crisis, access to FHA insured financing has been critical to bolstering the housing market and providing access to credit to creditworthy, low-wealth borrowers.

Figure 1. FHA Market Share as a Percent of Total Market



As has been true throughout its history, FHA is particularly important to borrowers that the conventional market does not adequately serve, including qualified borrowers who would otherwise be shut out of the mortgage market. According to the latest Home Mortgage Disclosure Act (HMDA) data, half of all African Americans who

purchased a home in 2011, and forty-nine percent of Hispanics, did so with FHA insured financing. Seventy-eight percent of the loans insured by FHA go to first time homebuyers.

FHA Single Family Programs

Redoubling Efforts to Keep Homeowners in their Homes

While there is work still to be done, HUD is proud of the progress this Administration has made in tackling ongoing foreclosure challenges. Between April 2009 and February 2013, more than 6.4 million foreclosure prevention actions were taken – including nearly 1.7 million FHA loss mitigation and early delinquency interventions.

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

- *FHA Streamline Refinance* – An option that allows borrowers with FHA-insured loans who are current on their mortgage to refinance into a new FHA-insured loan at today’s low interest rates without requiring additional underwriting, permitting these borrowers to reduce their mortgage payments. This program benefits current FHA borrowers – particularly those whose loan value may exceed the current value of their home – and, by lowering a borrower’s payment, also reduces risk to FHA. And, because we see potential for more widespread use of this product, FHA made changes to the way in which streamline refinance loans are displayed in the Neighborhood Watch Early Warning System (Neighborhood Watch) to encourage lenders to offer this product more widely to homeowners with FHA-insured mortgages, and offered reduced premiums for borrowers who could benefit most from a Streamline Refinance.
- *Changes to FHA’s Loss Mitigation Waterfall* – A Mortgagee Letter published on November 16, 2012, outlined changes to FHA’s loss mitigation home retention options. One of the key elements of this update was moving FHA’s Home Affordable Modification Program (HAMP) product up in FHA’s loss mitigation waterfall so servicers could more quickly offer deeper payment relief to struggling FHA borrowers, resulting in an increase in the number of borrowers being able to retain their homes.
- *Housing Counseling* – In FY 2014, HUD is requesting \$55 million in Housing Counseling Assistance, to improve access to quality affordable housing, expand homeownership opportunities, and preserve homeownership, all of which are especially critical in today’s economic climate. With this funding, HUD estimates that 2,650 HUD-approved counseling agencies, employing an estimated 8,000 housing counselors, will assist a total of 2.5 million renters and owners. In 2012, 2,410 HUD-Approved Housing Counseling agencies, with grant funds from HUD and other funding sources, assisted over 1.9 million renters and owners. HUD-approved counselors help clients learn about purchasing or refinancing a home; rental housing options; reverse mortgages for seniors; foreclosure prevention; loss mitigation; preventing evictions and homelessness; and moving from homelessness to a more stable housing situation.

HUD’s new Office of Housing Counseling has several initiatives to ensure borrowers know their rights and have access to the remedies that will allow them to stay in their homes. While HUD approved housing counselors serve all homeowners, regardless of the type of loan, effective loss mitigation for FHA borrowers also protects the Mutual Mortgage Insurance (MMI) Fund. Therefore, HUD has worked closely with interested states to determine effective ways in which funds from the National Mortgage Servicing Settlement can be used to expand housing counseling resources, resulting in more than \$300 million in settlement funds committed to housing counseling or legal services for affected borrowers. HUD-approved housing counseling agencies provided foreclosure prevention services to 774,000 families in fiscal year 2012.

In addition, FHA and the Office of Housing Counseling are exploring ways to further integrate housing counseling into the home purchase process, as well as continuing efforts around loss mitigation, offering

distressed FHA borrowers additional resources with which to assess their options and make decisions appropriate to their situation.

- *Short Refinance Option* – In 2010, FHA made available an option that offers underwater non-FHA borrowers, who are current on their existing mortgage and whose lenders agree to write off at least 10 percent of the unpaid principal balance of the first mortgage, the opportunity to refinance into a new FHA-insured mortgage. FHA made enhancements to the program in March of last year and announced an extension to the expiration date of the program in order to increase the number of borrowers who will benefit from this initiative.

Strengthening FHA and Paving the Way for Private Capital to Return

The President's Budget shows that FHA, while still under stress from legacy loans, has made significant progress and is on a sound fiscal path moving forward. Like nearly all mortgage market institutions, FHA sustained significant losses due to the precipitous fall in the housing market and home prices and is putting additional funds aside this year to cover those legacy losses. Moreover, like most other market participants, recent and future books of mortgage business are expected to bring healthy gains and perform well.

Throughout the economic crisis, as FHA faced fiscal challenges, this Administration took swift and effective action to protect the FHA and the American taxpayer alike, as FHA continued to fulfill its dual mission of supporting the housing market during tough times and providing access to homeownership for underserved populations. Of the changes made since 2009, FHA's lender oversight and credit policies have yielded substantial improvements in the quality of new loans endorsed by FHA, and premium increases have priced appropriately for risk. But significant opportunity remains to reduce the impact on the Fund of poorly performing legacy loans severely impacted by the recession, and to provide greater assistance for distressed borrowers as they seek to recover and find meaningful assistance in dealing with their delinquent loans. With a majority of FHA's projected losses attributable to loans insured from 2007-2009, FHA will take several additional steps to maximize recovery in the areas of loss mitigation and asset management.

Counterparty Risk Management and Lender Enforcement

One of the first things this Administration did upon taking office was to take strong actions to improve FHA's monitoring and oversight of lenders. This has included substantial improvements to risk analysis systems and procedures, and policy changes to focus resources on the areas of FHA's business which pose the greatest potential risk to the MMI Fund. These efforts have resulted in lenders being withdrawn from FHA programs, improvements in lender compliance with FHA requirements, and a number of settlements with lenders and servicers for violations of FHA origination or servicing requirements.

Yet, it remains important that we continue to clarify and refine the rules of the road for FHA lenders. That is why last month FHA issued a mortgagee letter implementing a Lender Insurance (LI) Lender Indemnification Final Rule which was published in January 2012. This guidance establishes better and more consistent monitoring of LI lenders and establishes clearer parameters upon which HUD will require indemnification for loans originated by these institutions.

Additionally, we have been concerned of late with a number of web-based and print advertisements that proclaim the supposed ease of obtaining an FHA-insured loan following a foreclosure. While FHA has taken a number of proactive steps in the past few years to clarify its requirements regarding lender advertising and to enforce those requirements aggressively, we determined in last year that it was necessary to address the issue of post-foreclosure advertising specifically. Therefore, on January 25, 2013 FHA issued a reminder to its industry partners that advertisements that imply that little or no qualification criteria are necessary to obtain an FHA loan are unacceptable and that FHA will not hesitate to take action within its authority to enforce its requirements related to lender advertising, including sanctions by HUD's Mortgagee Review Board and/or referral to the HUD Inspector General or the Consumer Financial Protection Bureau (CFPB).

Credit Policy

We have also worked to strengthen our credit policies for FHA borrowers. First and foremost, FHA implemented Congress's elimination of seller-funded down payment assistance programs which cost the MMI Fund more than \$15 billion in economic value. Further, we enacted increased down payment requirements for borrowers with credit scores below 580. The long-term positive impact of these two credit policy changes cannot be overstated. The 2005 – 2008 vintages, accounting for less than 15% of total originations over the last 30 years, are projected by the Actuary to contribute more than one-third of total credit losses of the Fund. Loans with credit scores below 580 and/or seller-funded down payment assistance will have accounted for 44% of those losses. Additionally, we will continue work on finalizing regulations to reduce the amount of allowable seller concessions that increase risks to FHA arising from inflated appraisals.

In late 2012, FHA announced several additional policy changes which continue its work to strengthen credit policy, support the ongoing recovery and maintain access to mortgage financing for credit worthy borrowers while also taking steps to recede FHA's total market share. These steps include requiring manual underwriting for borrowers with credit scores below 620 and debt to income (DTI) ratios over 43 percent, enhancements to FHA's TOTAL Scorecard, and a proposed increase in the required down payment for borrowers seeking loans in excess of \$625,500. Taken together with all the other measures outlined above as well as those detailed in Appendix A of FHA's Annual Report to Congress, these steps will ensure that home buyers using FHA-insured financing are capable of meeting their mortgage obligations and will not put undue stress on the Fund.

Increased Revenue

In addition to the improvements made to the quality of new endorsements, we have also made the difficult choice to increase mortgage insurance premiums for FHA-insured loans multiple times in the past four years. Since 2009, FHA has increased premiums five times – the most recent increase effective April 1, 2013. Combined, the premium increases made since 2009 have yielded more than \$10 billion in additional economic value for the Fund to date. These increases have not been undertaken lightly, and FHA has been careful to balance changes to pricing to improve the outlook of the Fund with its countercyclical role of providing liquidity and access to credit in the midst of the recent crisis and ongoing recovery.

Additionally, effective beginning with case numbers assigned on June 3, 2013, FHA will cease a policy of cancelling required mortgage insurance premiums (MIPs) on loans for which the outstanding principal balance reaches less than 78% of the original principal balance. Under that policy, FHA remained responsible for insuring 100% of the unpaid principal balance of a loan for the entire life of the loan, a period often extending far beyond the cessation of MIP payments. As written, the timing of MIP cancellation was directly tied to the contract mortgage rate, not to the actual loan LTV. That policy, which was reversed in a Mortgagee Letter published on January 31, 2013, was put in place at a time when it was assumed that home price values would not decline, but today we know that LTV measured by appraised value in a declining market can mean that actual LTVs are far higher than amortized mortgage LTV, resulting in higher losses for FHA on defaulted loans. Analyses conducted by FHA's Office of Risk Management projects lost revenue of approximately \$10 billion in the 2010-2012 vintages as a result of the current cancellation policy. The same analyses also suggest that 10%-12% of all claims losses will occur after MIP cancellation. Therefore, beginning in June, FHA plans to once again collect premiums based upon the unpaid principal balance of FHA loans for the entire period during which they are insured, permitting FHA to retain significant revenue that is currently being forfeited prematurely.

Loss Mitigation and Asset Management

The Actuary projects nearly \$60 billion in claims costs for FHA from seriously delinquent loans that will go to claim by the end of FY 2014, largely arising from loans insured between 2007 and 2009. As a result, reducing the severity of losses derived from these loans will exert a demonstrable positive impact to Fund performance over the next few years. Throughout the past fiscal year, FHA has been executing on an overall asset management strategy aimed at ramping up REO alternatives. REO alternatives (primarily short sales) comprised about 15%-20% of total dispositions since 2010, yielding average loss severities about 20% lower than REO. In recent months, as noted, FHA also unveiled its Distressed Asset Stabilization Program (DASP), another REO alternative that improves Fund performance. These and other actions have had a measurable effect, as loss severities have already fallen by 9% in the last year. A reduction in loss severities will further improve fund performance. And, compared to March of 2012, serious delinquencies are down in March 2013, with non-seasonally adjusted serious delinquencies dropping below 9% for the first time in over a year, showing that FHA and the market have made some progress in clearing the backlog of seriously delinquent loans previously withheld from a final disposition.

FHA expects further gains on this front through a number of initiatives:

- Streamlining of the FHA Short-sale Policy

Although FHA is deeply committed to providing loss mitigation alternatives to borrowers which permit them to retain their homes, home retention is simply not an option for some borrowers. For these borrowers, pre-foreclosure sales (short-sales) offer an opportunity to transition out of their homes. This enables both FHA and the borrowers to avoid the costs and damages of the foreclosure process. This month, FHA will introduce a streamlined pre-foreclosure sale policy which removes certain barriers for borrowers in obtaining a short sale on an FHA-insured mortgage. This change is expected to increase the number of defaulted loans that end in short sales rather than in foreclosures. Because losses from short-sales are substantially lower than from the traditional FHA REO process, the shift of greater numbers of distressed homeowners to short-sale dispositions rather than foreclosures is anticipated to yield better results for the MMI Fund while allowing distressed borrowers to start anew without having to go through the difficult and costly foreclosure process.

- Claim Without Conveyance Pilot Program

FHA is expanding a pilot in which properties secured by non-performing FHA-insured loans are offered for sale by the lender who has completed the foreclosure process. At a reserve price slightly below the outstanding unpaid principal balance of the loan, the properties are sold to third party purchasers without ever being conveyed to FHA. This method of disposing of these properties is expected to yield lower losses for the MMI Fund than selling them through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing an REO property are eliminated.

- Proactive Strategies to Further Improve Recoveries

In addition to the policy and programmatic changes outlined above, FHA will also take several innovative and proactive steps to increase utilization of loss mitigation options and reduce unnecessary asset disposition losses. First, beginning in 2013, FHA will launch a large-scale proactive marketing campaign to promote modification and short-sale strategies for delinquent borrowers. This effort is expected to increase utilization of these programs, which will permit more borrowers to become aware of and take advantage of these opportunities, while reducing foreclosures and decreasing associated losses for FHA. In addition, FHA will also pursue more creative strategies to dispose of REO properties in geographies where traditional asset disposition methods yield net negative recoveries for FHA. This approach is anticipated to both save money for FHA on unnecessary losses as well as contribute to community stabilization initiatives in cities hit hard by the recession.

Due to these changes, resulting in higher quality of loans and reduced loss severities, and combined with the large volume of current loans, we project FHA will generate approximately \$18 billion in receipts during fiscal year 2013. This includes \$3 billion generated from the new premium increase that went into effect April 1, 2013, and reversal of a policy that caused FHA to forfeit collection of MIP after a loan reached 78 percent of its original principal balance. Further, as a result of these same changes, the fiscal year 2014 budget projects FHA receipts of almost \$13B, even as FHA market share and loan volume continue to be reduced.

FY 2013 MMI Fund Budget Re-estimate

The President's budget forecasts that the FHA MMI Fund, which provides the fiscal capital to support FHA's single family and reverse mortgage guarantees, will use \$943 million of its mandatory appropriation authority to supplement its reserves at the end of fiscal year 2013. The MMI Fund currently has approximately \$32 billion in cash available to pay claims, so this is not a cash on hand problem; it is one of setting aside the right size of loan loss reserves. The \$943 million figure is based on an annual re-estimate of the reserves FHA will need to hold as of September 30, 2013, for the payment of expected losses over the next 30 years on its portfolio of guaranteed loans as of last September, based upon Federal Credit Reform Act (FCRA) scoring. This re-estimate is done as part of the development of the President's budget.

The potential for a mandatory appropriation to the MMI Fund is largely due to the existing reverse mortgage (Home Equity Conversion Mortgage or HECM) portfolio. This product, particularly as it has been structured to date, is sensitive to borrower longevity, home prices, and economic conditions. Lower than anticipated home price appreciation substantially affected the expected performance of the portfolio. Further, changes to the ways in which borrowers utilize the HECM product have shifted the risk profile of the program.

Originally designed to be used like an annuity, in recent years market circumstances and lender preferences have shifted greater numbers of borrowers to take full draws via the Fixed Rate Standard product. Thus, borrowers are taking all of the funds available to them up-front and often do not have the resources necessary in later years to pay property taxes and insurance, thereby triggering a default on the loan. Due to these changes in usage and performance, the budget estimates that the use of the HECM program results in a negative value of \$5.248 billion and a disproportionately negative impact to the Fund.

FHA will take immediate action under its limited authorities to better align the HECM program with its objective of enabling seniors to age-in-place. These changes, which will significantly impact consumer use of the program, will protect FHA from losses and reduce the likelihood of borrower defaults.

In administrative guidance dated January 30, 2013, FHA consolidated the Fixed Rate Standard program with the Fixed Rate HECM Saver product, which will result in a reduction of the maximum amount of funds available to a HECM borrower.

Additionally, in an effort to reduce losses associated with the conveyance and disposition of properties mortgaged with a HECM, FHA will issue new incentives for estate executors of HECM borrowers to dispose of properties themselves rather than conveying them to HUD. Executors are permitted to either sell such properties or convey them to HUD. Reversing the historical trend, over the past few years, larger numbers of executors have been choosing to convey these properties to FHA rather than sell them, adding costs and reducing recoveries for FHA. By incentivizing the sale of properties by executors, FHA is able to avoid property management, maintenance, and marketing costs associated with the REO disposition process, thereby reducing losses to the Fund on these properties.

Whether there will be an actual need for a mandatory appropriation from the Treasury General Fund to the MMI fund will not be determined until September 2013, and will be based on FHA's realized revenues and any other developments through the end of the fiscal year. Notably, any mandatory appropriation to FHA would not involve approval from Congress, as all federal loan programs have this standing authority. As we consider this potential mandatory appropriation, we must also acknowledge that FHA played a crucial, countercyclical role in bringing the housing market from the brink of collapse to a place where it is positive and growing again. This task did not come

without its stresses which we are experiencing today. Nevertheless, FHA will remain vigilant in implementing the policies and practices discussed here to protect the Fund.

Legislative Requests to Support FHA Single Family Programs

Since 2010, Congress has moved in important ways to strengthen and protect FHA. Indeed, were it not for the flexibility granted by Congress to FHA in setting mortgage insurance premiums, the current economic value of the MMI Fund would be more than \$10 billion lower than it is today. And the work Congress has done to establish FHA's first ever Office of Risk Management has been instrumental to our improved ability to identify risks in FHA programs and take action to mitigate them. We appreciate the commitment to making FHA stronger and more secure over the long term.

We have several legislative requests that, when coupled with actions taken previously and the support provided by this budget, will allow us to further strengthen the FHA fund and the larger housing market. The proposals outlined below will enhance FHA's ability to hold lenders accountable for non-compliance with FHA policy, allow FHA to increase recoveries on defaulted loans, and provide greater flexibility for FHA to make changes to policies and procedures as emerging needs and trends are identified. As a result, FHA will better be able to avoid unnecessary losses before they occur.

- *Indemnification Authority for Direct Endorsement Lenders:* This provision, which FHA has been seeking since 2010, would allow FHA to seek indemnification from Direct Endorsement lenders, which represent 70% of all FHA approved lenders. Currently FHA only has authority to require indemnification for lenders with Lender Insurance (LI) approval. In granting this authority, FHA will be able to obtain indemnification from all of its approved lenders for loans that do not comply with its guidelines.
- *Authority to Terminate Origination and Underwriting Approval:* This legislation would give FHA enhanced ability to review lender performance and, if a lender is found to have an excessive rate of early defaults or claims, would provide greater flexibility in terminating the approval of the lender to originate or underwrite single family mortgages for FHA insurance. FHA has been seeking this authority since 2010.
- *Revised Compare Ratio Requirement:* This provision would revise the statute governing the Credit Watch Termination Initiative to provide greater flexibility in establishing the metric by which FHA compares lender performance so that it more effectively captures the true performance of a lender during all market conditions, minimizing further poor performance by FHA lenders while reducing uncertainty for them. Specifically, this legislation would allow the Secretary to compare the rate of early defaults and claims for insured single family mortgage loans originated or underwritten by a lender with those same rates for other lenders on any basis the Secretary determines appropriate, such as geographic area, varying underwriting standards, or populations served. Further, the provision would permit the Secretary to implement such comparisons via regulations, notice, or Mortgagee Letter. This will allow FHA to tailor the compare ratio so it provides meaningful comparisons of lenders in varying market conditions, providing greater clarity for lenders and a more refined understanding of their performance for FHA.
- *Authority to Transfer Servicing:* In order to facilitate more effective loss mitigation, this change would give FHA the authority to require any of the following actions when a servicer is at or below a servicer tier ranking score (TRS) of III, or when the Secretary deems the action necessary to protect the interests of the MMI Fund: (1) transfer servicing from the current servicer to a specialty servicer designated by FHA; (2) require a servicer to enter into a sub-servicing arrangement with an entity identified by FHA; and/or (3) require a servicer to engage a third-party contractor to assist in some aspect of loss mitigation (e.g. borrower outreach). Such authority would permit FHA to better avoid losses arising from poor servicing of FHA-insured loans, yielding better results for both borrowers and FHA.
- *Authority to Structurally Change the HECM Program through Mortgagee Letter:* While the HECM product is an important tool to permit seniors to age in place, the challenges outlined previously necessitate immediate changes to the program. To make such changes in a timely fashion and preserve the program

for seniors, FHA is seeking statutory authority to temporarily make changes to the HECM program via Mortgagee Letter while formal rule making is simultaneously in progress. Specifically, FHA would make the following changes via Mortgagee Letter:

- Limit the amount of the allowable draw;
- Mandate the use of escrow accounts to ensure continued and timely payment of property charges including taxes and insurance, and;
- Require the use of a financial assessment as part of the loan origination process to ensure the appropriateness of HECM products for potential borrowers.

These changes will enable FHA to ensure that new HECM originations meet the needs of the target population and reduce risks to the MMI Fund. Absent ability to make these structural changes, later this Fiscal Year, FHA will have to take more dramatic action to ensure that new HECM originations are actuarially sound.

HECM Non-borrowing Spouse: The intent of the HECM program is to provide an age-in-place option for senior-citizen homeowners. However, from an operational standpoint, those homeowners must be party to the reverse mortgage for HUD to manage an actuarially sound program. Currently, if a mortgagor dies and no other HECM mortgagor continues to reside in the home, the loan becomes due and payable. The Department believes that in order to benefit from the HECM loan, a party must be eligible under the terms of the HECM, including the requirement that one be aged 62 or older and also have legal claim to the property. In order to clarify the responsibilities of non-borrowing spouses under the HECM program, HUD is proposing a General Provision in the FY 2014 Budget that amends the National Housing Act to clarify that the HECM becomes due and payable upon the death of the mortgagor spouse in order to avoid future misunderstanding. The proposed amendment would make clear that HUD's longstanding regulations – in effect since the beginning of the program – comport with Congress' original intent.

Meet the Need for Quality, Affordable Rental Homes and Healthcare Facilities

At a time when more than one-third of all American families rent their homes and over 8.5 million unassisted families with very low incomes spend more than 50 percent of their income on rent and/or live in severely inadequate conditions, it is more important than ever to provide a sufficient supply of affordable rental homes for families of modest means – particularly since, in many communities, affordable rental housing does not exist without public support. Compounded by an aging population and increasing health care costs, strong support for quality, accessible health care is also an essential component in achieving the Department's mission of strong, sustainable, inclusive communities and quality, affordable housing and services for all Americans.

Office of Multifamily Housing Programs

Reducing Administrative Burdens and Increasing Efficiency

This Budget recognizes the need to simplify, align, and reform programs to reduce administration burdens and increase efficiency across programs. The Office of Multifamily Housing is beginning to realize savings in Salaries and Expenses as a result of several major initiatives.

- *Breaking Ground.* Completed in mid-FY 2012, Breaking Ground was an initiative in Multifamily Housing Development to reduce backlogs, improve time frames, and create an early warning system that allows for more effective risk management by creating extensive tools to monitor and access credit for multifamily insured loans. These tools include a stronger credit review of borrowers; an early warning system that targets loans early in the process that do not meet FHA underwriting criteria; and a dashboard

monitoring tool to track accountability of field offices; and establishment of a queue in order to more efficiently manage workload and provide greater transparency to lenders.

Adopting this approach has produced positive results. Offices that had large application backlogs prior to Breaking Ground have reported processing efficiency improvements, methodically clearing out older applications – the number of applications in process for over 90 days dropped from 191 to 50 in just seven months. In addition, offices that began Breaking Ground without a large backlog have begun to meet aggressive application processing time cycles. The Department will continue to track these metrics and looks forward to reporting on these results.

- *Sustaining Our Investments.* The Sustaining Our Investments initiative, which was fully implemented last month, has resulted in an overhaul of the processes used to manage the portfolio of the Office of Multifamily Asset Management. The initiative focuses on Risk Based Management – allowing project managers at both the Headquarters and field level to focus day-to-day operations on managing at-risk loans in the portfolio. Risk-based reports keyed on financial and physical risk triggers direct project managers to act early on potential problems with particular assets. The first step in this initiative was to complete a full ranking of FHA’s entire multifamily market rate portfolio to better assess and address potential risk factors. The ranking of the non-insured portfolio is now underway.
- *Loan Committee.* FHA Multifamily has also implemented a new loan committee approval process, aligning Hub and Program Center commitment authority and practice to ensure consistency in underwriting throughout the regional offices, as well as to provide a platform to share best practices. Loan committees at the Hub and National levels provide oversight for high-risk transactions in the multifamily insurance program, based on loan size and a project’s number of units. Loan committee approval processes are standard practice in the lending community and are an important tool to prudently manage credit risks and ensure the integrity and stability of the GI/SRI insurance fund. The Loan Committee has also proven to be an effective tool for increasing communication and a more consistent FHA platform.

Adjusting Premiums to Properly Price for Risk

Given the unprecedented increase in the number and dollar volume of loans insured under the GI/SRI, particularly with respect to “market rate¹” loans, in the President’s Fiscal Year FY 2013 Budget proposal, the Department announced proposed premium increases for programs in the GI/SRI. Implemented on October 1, 2012, this was the first premium increase in 10 years for these programs.

GI/SRI funds provide financing for the FHA multifamily and healthcare loan guarantee programs and several very small specialized loan products. This account also continues to hold a sizable portfolio of single family loan guarantees (HECM, condominium, and rehabilitation loans) insured prior to FY 2009 when responsibility for new lending under these programs was transferred to the Mutual Mortgage Insurance Fund.

In contrast, premiums for single family programs situated in FHA Mutual Mortgage Insurance (MMI Fund) have been increased four times since 2010. As with the premium increases for MMI programs, higher premiums for market rate loans originated under the GI/SRI funds ensure that FHA products are priced appropriately to compensate for FHA’s risk, consistent with current market conditions. This premium change should also have the indirect benefit of encouraging the return of private capital to the nation’s mortgage markets.

¹ Generally, market rate housing covers a range of rental housing opportunities. In the FHA portfolio, market rate housing is generally affordable to those at approximately 80% of area median income.

Going forward, FHA will continue to examine its business models and practices, with an eye toward continuing to improve its risk management capabilities and operational efficiencies while expediting processing and approval timelines.

Rebuilding our Nation's Affordable Housing Stock

Over the last 75 years, the Federal Government has invested billions of dollars in the development and maintenance of public and multifamily housing, which serve as crucial resources for some of our country's most vulnerable families. Through its mortgage insurance programs, over just the past 18 months, FHA facilitated lending of \$4 billion for new construction and substantial rehabilitation of over 40,000 apartment units. FHA insured over \$11 billion of mortgages that supported improvements and moderate rehabilitation of more than 150,000 units of multifamily housing over the same period.

Despite this sizable federal investment and the great demand for deeply affordable rental housing, we continue to see a decline in the number of available affordable housing units. Unlike other forms of assisted housing that serve very similar populations, the public housing stock is nearly fully reliant on Federal appropriations from the Capital Fund to make capital repairs. Funding and regulatory constraints have impaired the ability for these local and state entities to keep up with needed life-cycle improvements. The most recent capital needs study of the public housing stock, completed in 2010, estimated the backlog of unmet need at approximately \$26 billion, or \$23,365 per unit. Available funding is vastly insufficient to meet accruing needs of approximately \$3 billion per year. Under the strain of this backlog, and without financing tools commonly available to other forms of affordable housing, the public housing inventory loses an average of 10,000 units annually through demolitions or dispositions. Through FHA and other programs, HUD is taking steps to address this shrinking inventory.

Rental Assistance Demonstration

In addition to the public housing stock, the RAD program targets certain "at-risk" HUD legacy programs. The 24,000 units assisted under Section 8 Moderate Rehabilitation (MR) are limited to short-term renewals and constrained rent levels that inhibit the recapitalization of the properties. The approximately 21,000 units assisted under Rent Supplement (RS) and Rental Assistance Program (RAP) have no ability to retain long-term project-based assistance beyond the current contract term. As a result, as their contracts expire, we can no longer depend on these projects to be available as affordable housing assets.

Conversion to long-term Section 8 rental assistance, as permitted under RAD, is essential to preserving these scarce affordable housing assets and protecting the investment of taxpayer dollars these programs represent. Long-term Section 8 rental assistance allows for state and local entities to leverage sources of private and public capital to rehabilitate their properties. While the Department expects and continues to process Public Housing conversions of assistance without additional subsidy, HUD requests \$10 million in fiscal year 2014 for the incremental subsidy costs of converting assistance under RAD for very limited purposes. Such funding will be targeted *only* to public housing projects that are: 1) not feasible to convert at current funding levels, and 2) located in high-poverty neighborhoods, including designated Promise Zones, where the Administration is supporting comprehensive revitalization efforts. The Department estimates that the \$10 million in incremental subsidies will support the conversion and redevelopment of approximately 3,300 public housing units that would not otherwise be feasible to convert and sufficiently stabilize over the long-term, while helping to increase private investment in the targeted projects and surrounding neighborhoods.

In addition to the funding request, each of the legislative requests in the 2014 Budget for RAD are designed to allow for maximum participation by those PHAs and owners whose current funding levels are sufficient for conversion. In the first component of RAD, an increase in the 60,000 unit cap to 150,000 units, and the *exclusion* of Section 8 MR properties from the cap will both allow for a greater portion of both the Public Housing and MR stock that can convert at no cost to the Federal government to participate in the demonstration. It is expected that approximately 40 percent of the transactions conducted through the RAD program will leverage FHA insured financing, actually contributing to the generation of offsetting negative subsidy receipts for the government.

Legislative Requests to Support Multifamily Housing

Nearly a third of the nation's renters, more than 20 million households, live in small, unsubsidized apartment buildings. These 5- to 49-unit properties tend to be owned by small businesses and are typically more affordable to low-and moderate income families. These properties are at risk of continued disinvestment as small building owners are less likely than other multifamily property owners to be able to secure financing for repairs and improvements. Small properties are less likely to have mortgage financing and just 14% of all FY10 FHA-insured properties were for projects with fewer than 50 units.

The fiscal year 2014 Budget includes a legislative provision to support small building finance, and to strengthen the Risk Share program as a rental finance tool, seeks Congressional authority for Ginnie Mae to guarantee securities containing FHA multifamily Risk Share loans, thereby increasing liquidity and decreasing cost of capital. This proposal would apply to both state and local Housing Finance Agency Risk Share lenders under Section 542(c) and new Risk Share lenders under Section 542(b). The proposal would also amend Section 542(b) of the statute to allow for flexibility in how affordability is determined in order to make it a more effective tool to recapitalize existing naturally affordable 5-49 unit rental properties.

- *Section 542(c) HFA Risk Share*
The extension of Ginnie Mae securitization to the 542(c) Risk Share program would improve HFAs' ability to finance affordable rental housing that serves some of the poorest and most vulnerable Americans, without requiring any federal budgetary appropriation.
- *Section 542(b) Risk Share and Small Building Finance*
The 542(b) Risk Share authorizing statute provides HUD with significant flexibility to take on risk-share partners. HUD plans to partner with mission-driven lenders to make loans on small multifamily rental buildings on a 50/50 risk share basis with HUD. In order for this program to work for small multifamily lending, two legislative changes are required. Access to Ginnie Mae guarantees for small building risk-share lenders combined with flexibility on the statutorily imposed risk share affordability standard which otherwise requires ongoing rent and income restrictions will allow us to use this tool to meet the needs of these smaller properties and prevent disinvestment in a valuable portion of our nation's housing stock.

Office of Healthcare Programs

FHA's healthcare programs for hospitals and residential care facilities (nursing homes, assisted living facilities, and board and care homes) have helped private lenders fill the gap left by shrinking conventional finance resources. Since 1934, over 4,000 Residential Care Facility mortgage insurance commitments were issued in all 50 states under the Section 232 program. In 1968, enabling legislation amending the National Housing Act was signing into law, creating the section 242 program for hospital facilities. Since the Section 242 program's inception, over 400 mortgage insurance commitments have been issued for hospitals in 42 states and Puerto Rico. And while the economy seems to be rebounding and with it, sources of private capital, we continue to expect high levels of mortgage insurance activity for Fiscal Year 2014 due in large part to refinancing activity as healthcare facilities take advantage of current low interest rates. Furthermore, following implementation of a final rule in 2013, hospitals can now obtain FHA-insured refinancing loans. As of December 31, 2012, the FHA's portfolio of healthcare loan guarantees had an unpaid principal balance of \$28.3 billion on 2,900 loans.

Evolution of FHA Healthcare Programs – Balancing Risk and Improving Processes

This Administration, in continuing to improve the program has brought in positive risk management changes to both balance risk and improve processes. Given the unprecedented increase in the number and dollar volume of loans insured under GI-SRI, in Fiscal Year 2013, premium increases for FHA's General Insurance and Special Risk Insurance healthcare programs were instituted to increase the stability of the insurance fund. With the premium increases, FHA Healthcare loans are priced more appropriately to encourage the return of private capital while, at the same time, continuing to ensure sufficient levels of available capital in these sectors.

Proactive Asset Management. In FHA's Office of Healthcare Programs, weekly loan committees are held to review and approve loan submissions and to monitor healthcare industry trends and risks. By implementing

proactive asset management using early intervention monitoring tools, the Office of Healthcare Programs succeeded in maintaining claim rates of less than one percent in both healthcare facility mortgage insurance programs in Fiscal Year 2012.

LEAN Business Process Reengineering. LEAN Business Process Reengineering has also played an integral part in streamlining business operations within FHA's healthcare programs. Despite volume increases, LEAN Processing improvements reduced loan processing times while increasing risk management efforts. Revised program requirements and documents were established to enhance accountability for borrowers, operators, and lenders. To further manage risk in the healthcare portfolio, in areas of large risk concentrations, such as insuring portfolios of multiple healthcare facilities, reviews are conducted at both the corporate and individual loan levels. In the residential care facility mortgage insurance program, implementation of a Master Lease Structure to cross-collateralize properties not only works to improve the overall risk profile of FHA's healthcare portfolio, but ultimately reduces claims.

The Office of Healthcare Programs is in ongoing collaboration with HHS, CMS, and state public health departments to support efforts to ensure quality of care for the most vulnerable populations. Also, by incorporating state survey inspection results, cost reports, and data from other federal and state agencies into FHA's underwriting and asset management procedures, the shared utilization of data and cross-collaboration has been instrumental in keeping healthcare claim rates low within FHA.

Legislative Request to Support Healthcare Programs

As part of the efforts of FHA's Healthcare programs to strengthen communities by addressing specialized financing needs, HUD is seeking passage of the language in the THUD Appropriations Bill to permit rural Critical Access Hospitals to be eligible for FHA insurance. Before their eligibility expired in 2011, 29 Critical Access Hospitals received FHA-insured loans, with results that were positive, both in terms of loan performance and the jobs created by hospital construction projects. Also, quality of life improved in their communities; these hospitals by definition are geographically remote from other hospitals, and they provide not only emergency, outpatient, and acute inpatient services but also nursing and rehabilitation services that avoid the need for the elderly and recuperating patients to leave the community for care.

We appreciate the Congress' long standing support for Critical Access Hospitals by amending Section 242 to permit these important facilities to be eligible for FHA insurance, and hope that this language will be approved to allow Critical Access Hospitals to continue to be eligible for FHA insurance.

Transforming the Way HUD Does Business

A 21st century American economy that is a magnet for jobs and equips its residents with the skills they need for those jobs demands a government that's leaner, smarter, and more transparent. The current economic and housing crisis; the structural affordability challenges facing low-income homeowners and renters; and the new, multidimensional challenges facing our urban, suburban, and rural communities all require a HUD and an FHA that can meet those challenges. As such, we remain committed to improving the way HUD does business. HUD remains at the forefront of the Federal response to the national mortgage crisis, economic recovery, Hurricane Sandy recovery, and the structural gap between household incomes and national housing prices – roles that require an agency that is nimble and market-savvy, with the capacity and expertise necessary to galvanize HUD's vast network of partners. HUD's 2014 Budget reflects these critical roles, by investing in transformation, research, and development that will be implemented persistently over time.

Strategically Investing In Our Staff While Improving Efficiencies and Processes

HUD's greatest resource is its dedicated staff. When employees attain skills and are motivated to use those skills to help their organization reach goals, the capacity of the organization grows and employees in the organization grow as well. This is why HUD is providing its employees training and leadership development opportunities. HUD is also in the process of simplifying and streamlining programs and reforming its information technology,

human resources, procurement, and other internal support functions to provide flexibility to managers and better service to HUD customers.

Multifamily Office Reorganization and Consolidation

Beginning in fiscal year 2013, the Office of Multifamily Housing will begin reorganizing its Headquarters structure and consolidating Field Office Operations. Phased in over two and a half years, this plan will increase efficiency and consistency, modernize our services, and once fully implemented has the potential to save an estimated \$40 to \$45 million in annual costs.

By taking proactive steps, the Office of Multifamily Housing Programs will better serve customers and stakeholders, by operating more efficiently and consistently and improving risk management, all in an era where HUD and agencies across the government are working diligently to determine how best to do more with less. This transformation builds upon the success of *Breaking Ground* and *Sustaining Our Investments* through four initiatives:

1. *Launching more routine and effective workload sharing across the country.* By more equitably distributing workloads in the areas of Production and Asset Management, Multifamily Housing will be able to reduce unevenly distributed pressure on staff and reduce customer wait times and the application backlog. A workload sharing pilot is already in process throughout the country, receiving positive feedback from customers and staff
2. *Introducing risk-based processing and underwriters in the Office of Multifamily Production.* In order to increase processing efficiencies, improving customer service and more effectively manage risk, FHA Multifamily will segment and process applications according to their risk profile and complexity, assigning an underwriter to oversee the review of the application from start to finish, drawing in technical experts as needed.
3. *Creating Specialist Support in the Office of Multifamily Asset Management.* The newly created positions of Troubled Asset Specialist and Account Executives will allow Multifamily to assign the most experienced staff to focus on risky, complex or troubled assets, ensuring that the most skilled staff is engaged to manage risk to the portfolio. Other Account Executives with less expertise will focus on non-troubled portfolio while building the expertise and skill sets to manage more complex transactions.
4. *Streamlining organizational structures.* In headquarters, FHA Multifamily will reduce the number of offices by merging the Office of Housing Assistance and Grants Administration and the Office of Housing Assistance Contract Administration Oversight into other existing Headquarters offices. A dedicated Associate Deputy Assistant Secretary role will be created to support the field while leadership also examines other offices for ways to streamline and reduce duplication of efforts. In the field, 17 hubs will be consolidated into five – and the total number of field offices with Multifamily presence will decline from 50 to 10. Affected employees will have the ability to relocate, accept a buy-out, or take early retirement.

Upgrading the Department's Information Technology Infrastructure

In fiscal year 2014, HUD is requesting \$285 million to support and modernize its information technology infrastructure. This request includes \$45 million for the development, modernization, and enhancement of key outdated systems; \$116 million for the operations and maintenance of our current systems; and \$124 million to complete the transition to our new IT Infrastructure system, HUDNET. Department-wide efforts will focus transitioning the department to a modern, sustainable IT infrastructure, and to continue the development of a modern financial management system that will improve HUD's ability to measure, track, and report on program

costs and efficacy, and transitioning the current FHA systems to a modern platform. These steps are integral to the build the FHA systems and tools needed to manage risk.

FHA in particular expects to expand its portfolio evaluation tool capacity to get an “early look” at where the value of the MMI fund is trending, and to incorporate new business policies or products when/where needed. HUD has begun to decommission legacy FHA applications and will continue this through the FY 2014 request, freeing up those IT dollars for reinvestment. These changes will allow HUD to deliver services and manage its multi-billion dollar programs faster, more accurately and using better information for analysis. These funds are crucial to complement HUD’s transformation efforts, providing resources for maintaining and improving Department-wide information technology systems.

Conclusion

Madam Chairman, the HUD Budget reflects the Administration's recognition of the critical role the housing sector must play to ensure that America becomes a magnet for jobs that strengthen the nation’s middle class, including providing ladders of economic opportunity for all Americans. Equally important, it expresses the confidence of the President in the capacity of HUD to meet a high standard of performance.

By targeting resources where they are most needed, making tough choices in order to do more with less, and ensuring the protection of taxpayer interests, FHA’s Single Family, Multifamily, and Healthcare Programs, are ensuring more Americans have the opportunity to realize or maintain the economic security of the middle class. Our focus on transforming the way we do business will ensure that we can continue to remain a relevant and effective support to the housing market – on that helps build the economy from the middle class out and ensures that we create opportunity for everyone, everywhere. Thank you.