THE FUTURE OF THE FEDERAL HOUSING ADMINISTRATION (FHA) AND THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GINNIE MAE)

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

10106

Table of Contents

Executive Summary

For many years, the Federal Housing Administration (FHA) and the Government National Mortgage Association (Ginnie Mae) have been the U.S. government's primary programs for making homeownership and rental housing accessible and affordable to America's middle-income families. In 2009, FHA recognized 75 years of existence, during which time 37 million Americans benefitted from its success serving the underserved, first-time, and low- and moderate-income homebuyers and renters.

The Mortgage Bankers Association (MBA) is a strong supporter of FHA and Ginnie Mae. Our members understand the value of FHA's programs to homebuyers, especially those who may need the features of FHA-insured loans to purchase their first homes, and we appreciate the market liquidity that Ginnie Mae provides. The significance of FHA and Ginnie Mae in the housing finance system has been underscored with the recent mortgage crisis that began in late 2006 and resulted in the retreat of the private sector and an illiquid mortgage market. FHA's counter-cyclical role has proven invaluable to maintaining liquidity in the mortgage market and has helped buttress the country's unstable housing finance system.

A wake-up call for FHA and the lending community occurred in September 2009, however, when the U.S. Department of Housing and Urban Development (HUD) announced that the capital reserve ratio for the Mutual Mortgage Insurance (MMI) Fund — the largest of FHA's four insurance funds — had dropped to 0.53 percent of the Fund amount, well below the requirement of two percent from the 1990 Cranston-Gonzalez National Affordable Housing Act.[1] While not a reason to panic, the Fund's reduction publically signaled to FHA and the mortgage industry that changes must be made. With the withdrawal of the private sector, FHA's market share has continued to increase and is close to 30 percent of all loan originations and has reached as high as 50 percent of purchase mortgage applications in parts of the country. This rise in loan volume and decrease in the MMI Fund have caused policymakers and industry experts to focus on what is needed to ensure the safety and continued availability of FHA and Ginnie Mae.

---

1 *Annual Management Report Fiscal Year 2009,* U.S. Federal Housing Administration (Nov 2009).

It was in the spirit of helping position FHA and Ginnie Mae to be strong, vibrant organizations that the *MBA Council on the Future of FHA and Ginnie Mae* (the Council) convened in November 2009 to begin an extensive retrospective on the housing boom and subsequent bust, including discussing recommendations on how to sustain FHA and Ginnie Mae during the housing crisis and keep them available and relevant into the future. The goal of the Council was to develop a comprehensive paper on "lessons learned" including recommendations for how those lessons can lay the groundwork for a robust and modernized future for FHA and Ginnie Mae. Another goal of the Council was to use the data gathered to articulate the critical areas where FHA and Ginnie Mae need continued focus as well as financial and staffing resources. The Council divided its recommendations into three categories: Capacity and Resources; Program Eligibility; and Operations and Delivery of Services. The recommendations for FHA contained in this paper include:

1. Give FHA and Ginnie Mae the needed appropriations to hire new staff.
2. Provide FHA with the needed appropriation to develop and implement modern information technology (IT) systems and processes, including anti-fraud tools. FHA should also refine the FHA TOTAL Scorecard.
3. Define and update FHA's mission, including a re-examination of the current FHA loan limits.
4. Strengthen the FHA reverse mortgage product (Home Equity Conversion Mortgage (HECM)).
5. Provide FHA with the expanded authority to increase premiums.
6. Give the FHA Commissioner the authority, with the concurrence of the HUD Secretary, General Counsel and Ginnie Mae president, to temporarily suspend problem lenders.
7. Balance FHA's proposed multifamily risk management protocol against the backdrop of rising affordable housing needs, declining incomes and the on-going credit crisis.
8. Examine the existing Homeownership Center and Hub structure.

For Ginnie Mae, the Council's recommendations include:

1. Seek appropriate staff levels.
2. Maintain Ginnie Mae's exemption from the Credit Reform Act of 1990.
3. Modify policy regarding advance funding facilities.
4. Clarify Home Equity Conversion Mortgage MBS issuer criteria.

MBA applauds FHA Commissioner David Stevens for the bold programmatic changes he has implemented in recent months that focus on risk management and protecting the MMI Fund. These changes include hiring a chief risk officer; raising the upfront premium from 1.75 percent to 2.25 for purchase money and refinance transactions; tightening the FHA condo policy; limiting cash-out refinances to 85 percent loan-to-value (LTV) from 95 percent LTV; clarifying FHA's appraisal policies; increasing lender net worth requirements during the next three years to a minimum of $1 million plus additional incremental net worth based on FHA volume up to a maximum net worth of $2.5 million; and, changing FHA's lender approval policy to eliminate FHA approval of loan correspondents.[2] Mortgage lenders have largely supported these efforts, recognizing that changes were necessary to protect the industry.

As policymakers continue to consider the role of FHA and Ginnie Mae, they should remember that these entities do not operate completely independently from other area of government involvement in the mortgage markets. In particular, the future of FHA and Ginnie Mae will be affected by decisions regarding the futures of government-sponsored enterprises (GSEs) Freddie Mac and Fannie Mae. Historically, the FHA borrower had a somewhat different profile than that of the Freddie Mac and Fannie Mae borrower. This difference is because the government guarantee that the lender receives on an FHA loan has provided an incentive for lenders to originate borrowers with more risk under the FHA insurance program versus the GSEs' programs. Additionally, private mortgage insurers, whose

2 Department of Housing and Urban Development, Mortgagee Letter 09-47, Home Equity Conversion Mortgage (HECM) Counseling Standardization and Roster Final Rule (Nov 2009); 09-46a, Temporary Guidance for Condominium Policy (Nov 2009); 09-46b, Condominium Approval Process for Single Family Housing (Nov 2009); 09-34, Home Equity Conversion Mortgage (HECM) — Principal Limit Factors (Sep 2009); 09-32, Revised Streamline Refinance Transactions (Sep 2009); 09-31, Strengthening Counterparty Risk Management (Sep 2009); 09-30, Appraisal Validity Periods (Sep 2009); 09-29, Appraiser Portability (Sep 2009); 09-28, Appraiser Independence (Sep 2009); 10-22, Home Equity Conversion Mortgage (HECM) Program Submission of Case Binder Documents (Jul 2010); 10-21, HUD Multifamily Risk Mitigation (Jul 2010); 10-20, Implementation of Final Rule FR 5356-F-08, "Federal Housing Administration: Continuation of FHA Reform — Strengthening Risk Management through Responsible FHA-Approved Lenders" (Jun 2010); 10-19, Streamline Refinance Transactions and FHA TOTAL Scorecard (May 2010); 10-08, HUD REO Appraisal Validity Period and Second Appraisals (Mar 2010); 10-03, Mortgage Approval for Single Family Programs — Extended Procedures for Terminating Underwriting Authority (Jan 2010); 10-02, Increase in Upfront Premiums for FHA Mortgage Insurance (Jan 2010).

insurance is required on GSE loans with LTVs over 80 percent, have imposed more strict underwriting guidelines and loan parameters for the mortgages they are willing to insure. Whether Freddie Mac and Fannie Mae remain GSEs or become government agencies, government regulated utilities, or any of the other possible outcomes in that important policy debate, will impact how FHA and Ginnie Mae are used and perceived in the future.

A summary of the Council's recommendations follows in Part I. These recommendations are divided into three categories: Capacity and Resources; Program Eligibility; and Operations and Delivery of Services, with separate sections for FHA and Ginnie Mae. In Part II, the Council provides a historical perspective on how FHA and Ginnie Mae evolved into the agencies they are today and why MBA believes the Council's recommendations are appropriate for ensuring their future. The three sections of Part II are: *The Rise and Fall of Subprime and Alt-A Lending — Where was FHA?; The Federal Housing Administration — Post Housing Boom;* and *Ginnie Mae.*

Part 1

Recommendations for FHA Sustained Activity and Responsible Growth

Capacity and Resources

1) Give FHA and Ginnie Mae the Needed Appropriations to Hire New Staff with Current Mortgage Market Skills and to Better Train Existing Staff

FHA has operated for years at staffing levels too low to adequately manage its loan volume — even when that volume was much lower than it is today. To manage the recent explosion in FHA volume, MBA recommends FHA be given the necessary resources to quickly recruit and employ additional staff with relevant mortgage market expertise. As one way to compare the hiring level at FHA with that at the GSEs, we note that on March 12, 2010, Fannie Mae had postings for 529 positions; Freddie Mac had 171 positions posted; and FHA had only six positions posted.

MBA also recommends that FHA have complete, direct hiring authority separate from HUD, which would ensure that the largest government mortgage entity has the ability to recruit and quickly hire the professional staff it needs to carry out its mission. The hiring process also is impaired by the on-going budgetary continuing resolutions that carry well into the next fiscal year before Congress passes appropriations bills. Each year, FHA has only a few months to do a full year of recruiting and hiring. For example, during a six-month period in 2006, close to 350 full-time employees were placed.

Additionally, MBA recommends that FHA and Ginnie Mae have the ability to recruit and pay staff at a higher federal pay scale on par with other “professional-grade” cabinet, regulatory, and independent agencies that require specialized expertise like the Federal Deposit Insurance Corporation (FDIC), U.S. Securities and Exchange Commission (SEC), Office of the Comptroller of the Currency (OCC) and the U.S. Patent and Trademark Office (PTO). In addition to the Special Pay levels, we recommend both agencies also have the ability to more broadly use retention allowances and recruitment bonuses.

In addition to hiring changes, FHA’s staff should undertake appropriate and up-to-date training in real estate finance and residential mortgage lending, including specialized training for its multifamily and healthcare programs. While adding more professionals and making sure FHA can compete for the talent it needs, it is equally as important that current staff receive additional training so they can manage the risks in the current and future pipeline of applications.

2) Provide FHA with the Needed Appropriation to Develop and Implement Modern IT Systems and Processes Including the Use of Anti-Fraud Tools. FHA Also Should Refine FHA TOTAL Scorecard and Continue the Implementation of Business Process Re-engineering within Select Programs

During the last 30 years, FHA's IT infrastructure has been developed by multiple, independent contractors. This has resulted in a situation where making even minor changes is overly expensive and time consuming. For example, FHA Single Family has approximately 36 disparate applications and databases, which cost millions of dollars each year to maintain. Furthermore, FHA does not have a centralized approach to systems. Each program office develops applications independently, causing redundancy and an overall lack of integration. In 2008, FHA began to update its processes, Web technologies, management tools and methodology to stay current with the industry; although FHA still is largely a paper driven organization both internally and externally. This work must continue and must be accelerated and prioritized as much as possible.

FHA typically gets a baseline appropriation that allows only routine maintenance of existing systems; however, there are IT solutions that FHA could implement within these funding constraints including utilizing software-as-a-service (SAAS) or cloud computing. To expedite this process, we recommend that FHA receives Working Capital Funds through a direct appropriation and be allowed to develop and implement needed IT systems independent of the HUD Chief Information Officer (CIO).

FHA could benefit from state-of-the-art IT systems and front-end anti-fraud tools. The HUD Fiscal Year (FY) 2010 budget includes $20 million for an FHA initiative to combat mortgage fraud and implement anti-fraud and other risk management tools. The proposed FY 2011 budget includes additional funds for risk management tools. MBA supports these budget items and encourages HUD to take full advantage of all appropriated dollars.

MBA recommends that, in order for FHA to improve the performance of its loans and thereby ensure the protection of its MMI and General and Special Risk Insurance Funds, it should employ a fraud monitoring and reporting tool as early in the origination process as possible and before consummation. A fraud tool should be implemented after the Computerized Homes Underwriting Management Systems (CHUMS) number is assigned and no later than the final scoring through TOTAL Scorecard.

As FHA is assessing all of its risk management tools and polices, MBA recommends that the agency completely reexamine FHA TOTAL Scorecard in order to improve its reliability and functionality. In particular, such an evaluation should review the thoroughness of the scorecard's borrower risk assessment capabilities. When such a review is conducted and subsequent improvements are made, MBA recommends that FHA provide lenders who rely on the underwriting decision of TOTAL Scorecard with rep and warrant relief and an exemption from Neighborhood Watch. This policy would be similar to the rep and warrant relief that Fannie Mae[3] and Freddie Mac[4] provide to lenders that use their automated underwriting systems.

We further recommend that FHA consider a separate risk management practice that would take place after the endorsement and involve expert third-party providers who could aid in the auditing of FHA insurance claims. These outside entities could help validate the loan against FHA underwriting guidelines as well as uncover any instances of material misrepresentation. This practice has been used extensively for years in the private mortgage insurance industry and has resulted in restoring billions of dollars to their collective balance sheets.

In early 2008, FHA began an effort to better manage and improve its key customer-interface processes with an eye towards improved customer value and organizational success and sustainability. The FHA Quality Initiative, as it was known, began applying "LEAN" office techniques.[5]

The first HUD office to participate in LEAN was the Office of Insured Health Care Facilities (OIHCF) Section 232 program, followed by OIHCF's Section 242 program and finally the Office of Single Family Housing Philadelphia Homeownership Center (HOC). Following the participatory process that is the

---

3 *Selling Guide: Fannie Mae Single Family,* Fannie Mae. (Jun 2010).

4 *Single Family Seller/Servicer Guide,* Freddie Mac (2010).

5 *General Overview of FHA Insurance and LEAN Section 232,* Department of Housing and Urban Development, <http://portal.hud.gov/portal/page/portal/HUD/federal_housing_administration/healthcare_facilities/section_232/lean_processing_page/general_overview_of_fha_insurance>.

hallmark of LEAN, FHA's staff was able to bring about cost savings through the streamlining and consolidation of various steps within the overall workflow process.

While lenders acknowledge the LEAN effort was the right approach in theory and still support it, in practice it has not improved the processes it was designed to reengineer. MBA recommends that FHA meet with lenders to determine where the LEAN program has not met expectations and how to correct the program from an operational and implementation standpoint.

Program Eligibility

1) Define and Update FHA's Mission Including Examining the Current FHA Loan Limits to Determine if they are Appropriate Given the Decline in House Prices

Recent actions at HUD and FHA have caused some policymakers and industry leaders to consider whether FHA is being true to its original mission to help meet the housing needs of America's middle-income families. For example, due to the passage of the Economic Stimulus Act of 2008, FHA's single family loan limits are now the greater of $271,050 or 125 percent of area median home prices, capped at $729,750 in high-cost areas.

Members on the Council raised this issue because they consider it central to the debate on what FHA will look like in the future. Homebuyers who are able to qualify for loans at the upper loan limit in high-cost areas need to have an income of approximately $183,000, assuming a 4.5 percent interest rate. Where one lives generally shapes one's opinion about whether a borrower or family earning this income meets the definition of FHA's mission population. Regardless of one's opinion, determining if FHA should adopt its temporary loan limits as permanent loan limits depends in part on what type of homebuyer FHA considers its target market.

FHA's loan limits were raised to provide access to FHA financing for low-to-moderate-income homebuyers who live in high-cost areas of the country. To date, the origination of FHA mortgages at these jumbo loan levels has been fairly small. Originally set to expire on December 31, 2009, a FY 2010 continuing resolution extended these higher single family loan limits through December 31,

2010. The FY 2011 HUD appropriations bill (H.R. 5850), passed by the House in July and pending in the Senate, would extend the current higher loan limits through September 30, 2011.

When house prices stabilize and house price appreciation returns, however, the need for FHA to maintain the increased loan limits should be revisited. Some stakeholders in the debate will undoubtedly argue that widening FHA's borrower pool to those with higher incomes in high-cost states may benefit the FHA insurance fund and therefore enhance its ability to meet the traditionally defined mission. In this way, allowing purchases at the increased loan levels in high-cost areas may not take away from the agency's mission of meeting the home buying needs of underserved borrowers.

In contrast, MBA asserts that, as the housing market stabilizes and the private market returns, the need for FHA to maintain the increased loan limits should be reconsidered. MBA supports a decrease in FHA's loan limit after the stabilization of the housing market and a return of private financing. Any specific decreased loan limit, and whether it should be a nationwide loan limit or change by locality based on county or MSA data, should be determined based on the structure of the conforming loan limit for Fannie Mae and Freddie Mac or their replacements. A mechanism should be developed so that loan limits bear reasonable relationship to median home prices to encourage both government and private lending.

Other changes within FHA to allow it to compete with the conventional mortgage market may be more in line with meeting the traditional mission of FHA. As such, MBA would recommend beginning the loan limit discussion with a review and debate of the pros and cons of the following:

a. A single, nationwide limit; or

b. County-by-county loan limits up to 125 percent of area median home prices as established by the Federal Housing Finance Agency (FHFA), not to exceed $625,500; or

c. County-by-county loan limits up to 125 percent of area median home prices as established by FHFA, not to exceed $417,000.

Additionally, FHA's statutory limits for multifamily financing, while sufficiently high in most markets, are severely restricting the ability of rental property owners in high-cost urban markets to use FHA insurance programs. MBA applauds the House passage of H.R. 3527 on September 15th, 2009 and H.R. 5072 on June 10, 2010. These bills, along with S. 3700 which was introduced in the Senate on August 4th, 2010, would increase the FHA loan limits for elevator properties in extremely high-cost areas. Because many MBA members originate loans in markets with higher labor, material, regulatory and land costs, there is a gap between the mortgageable amount needed to finance construction or substantial rehab of units in the nation's major cities and HUD's statutory loan limits for multifamily properties. MBA calls for additional discretion to be given to the HUD Secretary to be used in extremely high-cost areas (similar to that provided in Alaska and Hawaii today). Senate action is needed as soon as possible on this legislation.

2) The FHA Reverse Mortgage Product (Home Equity Conversion Mortgage (HECM)) Should Be Strengthened and Embraced as a Viable and Helpful Product for Many Senior Citizens

The HECM product is the only government program that helps senior citizens "age in place," while also providing them income through access to the equity in their homes. The continued erosion of house prices, however, has jeopardized the program's future by impacting its actuarial foundation. The future remains uncertain for HECMs and it is almost certain that further modifications to the program will be made. Additionally, Congress will need to appropriate sufficient funds in FY 2011 to keep the program available to seniors.

The uncertainty around the future of the HECM product could not come at a worse time. The number of senior citizens will continue to grow for the foreseeable future. According to the Census Bureau's projections, the 65-and-older population is expected to increase by almost 150 percent between 2000 and 2050. By comparison, the population as a whole during the same period is expected to increase by only 49 percent.[6] The federal government provides very few non-institutionalized housing options for seniors beyond what is provided through HUD's multifamily project-based Section 8 and Section 202 programs, and those programs are targeted only for very low-income seniors. This fact makes the reverse mortgage program attractive for low- and middle-income seniors who often have very few other options.

In addition to the fiscal concerns, there has been a recent increase in negative media attention on the HECM program. A small number of unscrupulous lenders have given reverse mortgage lending a bad name and fueled a damaging public perception about HECMs. Continued bad press will only

6 News Release U.S. Census Bureau (CB06-FF.05. March).

cause seniors to view the program more suspiciously, even though it may be the best financial option for their specific situation.

MBA recommends that FHA continue to convene working groups of industry associations, housing advocates, federal financial regulators and related organizations to help develop solutions to ensure the long-term viability of the HECM program. Specifically, MBA proposes addressing the structural impediments, such as the amount of the upfront fees, of the HECM product in order to increase its attractiveness to consumers, while also enhancing the FHA insurance fund. MBA believes addressing these concerns, while also considering ways to improve the public perception of reverse mortgages, will help sustain the program's role in the marketplace.

Operations and Delivery of Services

1) Provide FHA with the Expanded Authority to Increase the Premiums to a New Ceiling When Warranted. This Authority Should Not Apply to Increases in the Down Payment Unless FHA Follows the Administrative Procedures Act Requirements

Protecting the insurance fund is a primary responsibility of the FHA commissioner; therefore, the person in that position should have the ability to adjust premiums and underwriting guidelines, as economic situations warrant. Under current law, the up-front mortgage insurance premium is capped at 2.25 percent. Congress recently passed H.R. 5981, the Single Family Mortgage Insurance Act,[7] which gave FHA authority to raise the annual premium from 0.55 percent to 1.55 percent. MBA supports this increase, provided it is paired with a corresponding decrease in the up-front premium. FHA Commissioner David Stevens has stated that FHA intends to raise the annual premium to 85 basis points for loans with LTVs up to 95 percent and to 90 basis points for loans above 95 percent. FHA would then lower the upfront mortgage insurance premium from 225 to 100 basis points.

By statute, the FHA minimum down payment requirement is set at a minimum 3.5 percent. The HUD Office of the General Counsel has recently opined that FHA can increase the minimum cash investment as high as the Commissioner determines, without legislation. At this time, MBA does not

7 Signed by President Obama on August 11, 2010, and became Public Law No: 111-229.

support a legislative increase in the minimum downpayment for borrowers other than those who have credit scores under 580. Due to the serious public policy impact of such a decision, if such time arises when HUD would consider increasing the minimum downpayment for all borrowers, MBA recommends that any increase must undergo a formal administrative process, such as Advance Notice of Proposed Rulemaking and a Public Notice and Comment period.

2) Give the FHA Commissioner the Unilateral Authority (with Concurrence) to Temporarily Suspend Problem Lenders

With the dramatic and rapid rise in FHA popularity since 2008, more lenders sought authority to originate FHA-insured loans. The pipeline for lender approval was so overextended that the lender approval processing time increased to more than 120 days in 2008. With this newfound growth came an increase in problems associated with lender underwriting and processing. As a result, FHA launched several "SWAT" teams in the spring of 2009 to conduct on-site reviews of ten FHA lenders with high compare ratios.[8] This effort was undertaken in conjunction with FHA's existing on-site monitoring and compliance visits. FHA also released Mortgagee Letter 2009-12 in April 2009 to remind lenders of their financial responsibility when originating FHA loans. In January 2010, FHA and the HUD Office of the Inspector General (OIG) announced more initiatives aimed at strengthening their lender enforcement efforts specifically targeted at lenders with high claim and default rates.

Currently, the Mortgagee Review Board[9] is the only vehicle available to FHA to suspend lenders. That process can take several weeks and sometimes even months. If FHA knows a lender's portfolio is experiencing stress, MBA believes the Commissioner should have the authority to temporarily suspend the lender pending a more expansive review and on-site visit. The Ginnie Mae president has this suspension authority and it is appropriate the FHA commissioner have similar authority. MBA would recommend that the Commissioner be required to secure the concurrence of the HUD Secretary, General Counsel, and, in the case of lenders who are Ginnie Mae issuers, the Ginnie Mae president.

Importantly, unless there is reason to believe criminal activity also has occurred, FHA-approved lenders should be afforded due process and allowed the opportunity to address FHA concerns before

8 FHA "SWAT" teams stand for Special Work Assessment Teams. Department of Housing and Urban Development, Mortgagee Letter 09-12, *Mortgagee Monitoring,* (Apr. 2, 2009).

9 See http://www.hud.gov/offices/hsg/sfh/mrb/mrbhome.cfm for more about the MRB.

subpoenas are made public. Making subpoenas public could permanently damage the reputation of a lender, unnecessarily in some circumstances.

3) FHA Should Balance its Proposed Multifamily Risk-Management Protocol against a Backdrop of Rising Affordable Housing Needs, Declining Family Incomes, and the On-Going Credit Crisis

Historically, FHA multifamily programs have helped trigger redevelopment of distressed neighborhoods while also providing jobs and economic development for local governments. Like FHA single family programs, the FHA multifamily programs operate at very little cost to the U.S. government and typically generate revenue through the mortgage insurance premiums, even after paying insurance claims for any loan losses.

Similarly to single family programs, volume in the FHA multifamily portfolio has increased over the last two years and many new lenders have recognized the value of the multifamily and healthcare insurance programs. The multifamily and healthcare portfolios, however, will not be immune from the nationwide devaluation of property values, and MBA anticipates some increases in defaults, particularly in markets hit hard by systemic unemployment and high foreclosure rates. Like the single family housing office, which continues to overlay new risk management initiatives to improve the quality of its portfolio, the Office of Multifamily Housing and the Office of Insured Healthcare Facilities are also striving to strengthen loan characteristics and increase mortgage liquidity while dealing with an anticipated increase in defaults.

One of the trends that FHA should monitor is the increased use of FHA multifamily and healthcare financing for market rate properties, where vacancies have risen over the past three years. FHA multifamily has announced risk management initiatives, including tighter underwriting criteria, new loan performance metrics and higher lender capital requirements to better manage both existing risk and, reportedly, an increase in claims for insurance. These risk management efforts will build more capacity in the multifamily programs to assess risk, the cornerstone to ensuring a higher quality of loans in the multifamily and healthcare insurance funds.

In order for the nation's housing needs to be met though, there must be a balanced approach toward housing choices. Rental housing should be included as a viable and well-regarded option.

MBA encourages FHA to act judiciously when managing risk in its multifamily portfolio and balance the need for rental housing with risk management changes, particularly for the millions of working families that have found it harder and harder to find affordable homes near where they work. A recent study released MBA found that overcrowding in the nation has increased five-fold since 2006.[10] While MBA supports a more robust credit management system, our members also support a system for managing counterparty risk that balances the need for FHA to remain active in the affordable multifamily and healthcare markets. As a result of FHA's plan to apply tighter underwriting standards on a one-size-fits-all approach, i.e., across all markets in all states uniformly. This tightening will slow the supply of credit, even where market fundamentals are improving.

MBA believes a lender should be able to underwrite using a minimum 1.20 debt-service coverage ratio (DSCR) regardless of the level of prior month's economic occupancy. Increasing collateral requirements such as working capital and contingencies for construction cost overruns are prudent steps to counter leasing deficiencies in weak markets. In some markets, HUD's proposed tightening of standards for minimum occupancy and holding back loan proceeds on property refinances until stabilization of the property is warranted in this environment.

In terms of risk management, FHA has taken the necessary steps to increase the net worth requirement to be an approved lender. For too long, the net worth requirements have been too low, and this increase is long overdue. But MBA also believes the increase in FHA's net worth for multifamily lenders does not reflect the role FHA plays and is excessive. In its multifamily programs, FHA takes a more aggressive position vis-à-vis its risk as insurer of the mortgage loan. For example, through its loan documentation, FHA establishes a direct relationship with the borrower (i.e., not through the lender) that regulates property characteristics such as rents, and adds strict reporting requirements by the borrower directly to HUD. FHA also subjects loans to a long and thorough process of review and approval prior to committing to insure any multifamily loan.

---

10 Painter, Gary. *What Happens to Household Formation in a Recession?* Research Institute for Housing America (RIHA) and Mortgage Bankers Association (Apr 2010).

MBA supports an increase in minimum net worth, but continues to believe that the maximum net worth requirements are excessive in relationship to the actual risk to a lender's balance sheet under HUD's Multifamily Insured Mortgage Program. The program does not require the lender to capitalize loan losses. The primary function of capital is to insure each lender has the wherewithal to fund its operations, which is a smaller level of capital than the FHA requirements to accrue capital based on the size of their portfolio.

4) Examine the Existing Homeownership Center (Single Family) and Hub / Field Office (Multifamily) Structure to Improve Efficiency and Consistency

HUD and FHA use a large network of regional and field offices to conduct most of the financial assessments and loan application reviews for both multifamily and single family loan file processing. This decentralization of the decision-making process has increased the velocity of the process but also has made for inconsistent policies and procedures, particularly within the multifamily housing program. MBA recommends that FHA address lender concerns with the decentralized structure of field offices within multifamily housing. For example, one action they can take is to begin training field staff in real estate mortgage credit and finance.

Similarly, the four national Homeownership Centers (HOCs) could be better aligned so they provide a consistent level of service and program and process guidance, specifically with regard to lender compliance and monitoring.

MBA recommends both the single family and multifamily field offices be part of a HUD initiative to better align its resources geographically with the areas where they are most in demand.

Recommendations for Ginnie Mae
Sustained Activity and Responsible Growth

Capacity and Resources

1) Seek Appropriate Staff Levels

Personnel with certain functional expertise are critical to the Ginnie Mae organization. Since 2007, Ginnie Mae has experienced a 400 percent increase in securities issued with no significant increase in the number of full-time employees. This incredible growth in business levels requires additional expertise in the areas of operations, risk management and customer service. This serious situation is not only a concern, but also has impaired some issuers' ability to achieve timely contact with Ginnie Mae staff.

We recommend that additional staffing resources be a top priority because of the impact staffing has on Ginnie Mae and its mortgage-backed securities (MBS). We believe inadequate funding endangers the viability of the organization and potentially undermines the integrity of the Ginnie Mae security. In the long term, we are concerned it will impact Ginnie Mae's ability to meet its mission of helping low- and moderate-income borrowers achieve homeownership and tenants find an adequate supply of safe and decent rental housing.

2) Maintain Ginnie Mae's exemption from the Credit Reform Act of 1990

MBA recommends that Ginnie Mae should not be placed under the Credit Reform Act of 1990, as often suggested by the Office of Management and Budget (OMB). If placed under the Act, Ginnie Mae would be required to have all of its funding appropriated by Congress. Today, Ginnie Mae operates under apportionment, meaning it can pay its expenses out of receipts without congressional approval. Additionally, given the enormous increase in volume, Ginnie Mae should be allowed to create a reserve against potential credit or counterparty losses.

Operations and Delivery of Services

1) Modify Policy Regarding Advance Funding Facilities

Recently, Ginnie Mae has made a concerted effort to change its policies to better align them with the independent mortgage banker business model. Notably, allowing single-loan pooling, as opposed to the three-loan minimum requirement, and permitting lenders to issue pools at any time of the month will certainly help the flow of liquidity.

Participation in the Ginnie Mae program can require significant liquidity as issuers are required to advance principle and interest payments on delinquent collateral. At the same time, obtaining funding for advances for many non-depository institutions that participate in the Ginnie Mae program can be difficult. We request that Ginnie Mae explore program changes to help address the liquidity concerns of these issuers while still protecting the Ginnie Mae program from unnecessary risk.

2) Clarify Home Equity Conversion Mortgage MBS Issuer Criteria

As discussed above, the HECM program is an important option for senior citizens. This innovative program was developed by FHA and has the potential to help millions of seniors remain in their homes as they age during the next few decades. Recent and potential changes to the program, in particular the 10 percent decrease in the principal limit factor, have caused concern that fewer seniors will benefit from this mortgage program. The liquidity of Ginnie Mae's HECM MBS (HMBS) program is another area that should be addressed.

Ginnie Mae issued the first Ginnie Mae security backed by HECM loans, the HMBS, in November 2007. At the time, industry analysts said the HMBS would increase the volume of HECM mortgages originated and enhance the affordability of these mortgage products for seniors by enhancing the liquidity of the HECM product. However, the HMBS got off to a slow start.

Before HMBS, Fannie Mae was the primary purchaser of closed HECM mortgages — buying through the cash window and placing them on Fannie Mae's balance sheet. That worked well for the industry until Fannie Mae was placed into conservatorship. Not long after that event, Fannie Mae was forced to close the window and sellers began to look for alternative means of liquidity for FHA-insured reverse mortgages.

This lack of other options led to an increase in use of the HMBS program by the larger issuers. Unfortunately, there are only nine approved Ginnie Mae HMBS issuers and only five of the nine are active today. Additional qualified and well-capitalized issuers may benefit the HECM product and America's seniors by increasing availability and understanding of the product and encouraging price competition. One reason there are so few issuers may be a lack of understanding by lenders of the Ginnie Mae requirements to become an HMBS issuer.

MBA recommends that Ginnie Mae make an effort to attract more qualified and well-capitalized issuers by establishing HMBS issuer criteria that supports the long-term viability of the HMBS program.

The Rise and Fall of Subprime and Alt-A Lending — Where was FHA?

Subprime lending or lending to borrowers with poor credit histories, grew from about 10 percent of mortgage originations to approximately 35 percent of mortgage originations during the years 2001 through 2005. During those years, subprime lending was credited with increasing the homeownership rate to an all-time high of 69 percent and also helped push the rate of minority homeownership to its highest level. Consumers with credit blemishes who traditionally might have been denied mortgages by mainstream lenders were given an opportunity for homeownership.

Using credit scores and technological advances that made risk-based pricing more sophisticated, a growing number of lenders believed they could price for the increased risk of these borrowers and charge higher fees to ensure bigger profits. Wall Street also saw an opportunity for high profits and was eager to purchase these mortgages for asset-backed securities that in turn were in demand by both domestic and foreign investors. Profits from subprime lending were significant for all participants.

Mortgage products such as the 2/28 and 3/27 adjustable rate mortgages (ARMs) offered the borrower a low rate for the first two or three years with an increase in rate after the initial fixed period. The low initial rate allowed borrowers to qualify for larger mortgage amounts. Many borrowers were led to believe they would never have to pay a higher interest rate because they could refinance before the initial period ended.

On a parallel track, during the years 2000-2003, low interest rates were leading to enormous increases in prime mortgage originations and home prices began their long period of escalation. According to *Inside Mortgage Finance,* in 2000, slightly more than $1 trillion in mortgages were originated; by 2003, the volume had nearly quadrupled to just under $4 trillion.[11] Available money at low rates contributed to the run-up in house prices.

In 2004, after years of steady low interest rates, annually increasing mortgage origination volumes, and enormous increases in home values, interest rates began to inch higher. Between interest rate increases and the continued appreciation of house prices, housing became less affordable, especially

11 Baily, Martin Neil, Robert E. Litan, and Matthew S. Johnson, *The Origins of the Financial Crisis,* The Initiative on Business and Public Policy, Brookings Institute (November 2008).

in the states of California, New York, Nevada and Arizona. While the demand for new mortgages began to fall, mortgage originations still amounted to about $3 trillion in 2004.

During this time, some mortgage lenders were looking for ways to keep originations high and the housing market strong. Some lenders chasing volume and market share in the purchase and refinance markets were looking for ways to help borrowers stretch their money and buy their "dream home." Subprime lending continued strong and Alt-A lending became increasingly popular.

While generally made to borrowers with good credit, Alt-A products typically included underwriting concessions such as stated income or higher debt-to-income ratios. Loan products such as option ARMs, stated income, and interest-only became popular for both Alt-A and subprime borrowers. Fueled by investors and aggregators, some lenders also began to ease underwriting standards in a reckless effort to drive up mortgage origination volume.

Underlying the knowledge that these types of loans combined with loosened underwriting requirements were placing both borrowers and lenders at risk was the belief that home values would continue to rise and equity in homes would continue to grow. Many borrowers believed the market would continue its steep climb unabated and they would have the option to refinance their mortgages or sell their homes if they had trouble making their mortgage payments.

In late 2006, the housing market began to crumble — the venerable housing engine had finally run out of steam.

Interest rates on the ARMs to subprime borrowers and Alt-A borrowers began to adjust upward. Many borrowers were finding it increasingly difficult to make their payments and, as property values began to drop, were unable to refinance. The safety net of home equity had evaporated for recent vintage mortgages. Loan-to-value ratios prohibited borrowers from refinancing out of their ARMs and the market for home sales weakened further. Suddenly, many borrowers were saddled with higher mortgage payments than they could afford. For some borrowers, default was almost inevitable.

As defaults and foreclosures in the subprime market became more and more prevalent, subprime lenders began to fail. Institutions heavily invested in mortgage-backed securities and other instruments backed by these now "toxic" assets also began to fail as the value of the securities plummeted. All participants in the housing market were affected.

Homeowners, homebuilders, real estate agents, mortgage lenders, securitizers, mortgage insurance companies and purchasers of mortgages and mortgage-backed assets all felt the impact. The broad reach of the housing market began to have a negative influence on the economy as a whole.

As more homes were foreclosed, property values fell faster. Many borrowers owed more money on their mortgages than their homes were worth. Borrowers began to walk away from their homes rather than continue to put money toward assets that were under water. The effect has been a downward spiral of heightened delinquencies, increased foreclosures, neighborhoods overwhelmed by vacant properties and properties in foreclosure and the subsequent further decline in property values.

Servicers continue to be overwhelmed by the volume of delinquencies and foreclosures. They are working hard to mitigate losses, do the right thing for borrowers, and reduce real estate owned (REO) inventory. Although there are indications that the housing market is improving as interest rates have been low, home prices are more affordable, and housing starts have picked up, many lenders remain unconvinced the tide has turned. Many are only making the best of loans to the most credit-worthy borrowers — adding their own restrictive guidelines to those of their investors.

Federal Housing Administration — Post Housing Boom

Many of FHA's traditional borrowers — those with relatively weak credit and minimal funds for a down payment — abandoned FHA during the housing boom. FHA's underwriting was perceived as overly rigorous and did not offer the option of a 100 percent Loan-to-Value (LTV) loan. From 2003 until 2007 FHA's share of the mortgage market hovered between two and seven percent. Its flagship 30-year fixed rate mortgage was shunned by many borrowers looking for the very lowest initial interest rate and payment — a key selling point of the 2/28 mortgage and Option ARM. Overlay a general belief that FHA loans were too complicated, compared to conventional or subprime loans, and it was no surprise FHA was not the first choice for many real estate brokers and lenders.

That began to change in mid-2006 into 2007.

Borrowers by the hundreds of thousands, especially those looking to get out from under their exotic mortgages with increasingly onerous payments, were looking for a lifeline. Most homeowners wanted to refinance. While many of the existing mortgages financed investment properties intended for quick sale and making a fast buck, many homebuyers simply bought expensive houses they could not afford. In hindsight, many borrowers in both categories were less than honest regarding their financial situation and ability to repay.

The Economic Stimulus Act of 2008 increased both conventional and FHA loan limits throughout the country, and especially in high-cost areas, to unprecedented levels in March 2008. The approximately 75 highest cost counties in the nation saw the FHA loan limits jump from $362,790 to $729,750. Another 500 counties had new loan limits set somewhere between $280,000 and $729,750. The remaining 2,500 counties had new loan limits of $280,000, up from $200,000. The once dormant FHA was now relevant and in high demand from coast to coast.

Crucially, FHA was hobbled by an onerous type of down payment assistance that had surfaced in the late 1990s. Operating as “charities,” organizations offered Seller-Funded Down Payment Assistance programs (SFDPAs) sprang up across the country offering “zero-down” FHA loans.

Through a seller “donation” to the SFDPA charity (typically an amount equal to the then required three percent down payment), the homebuyer had the funds for the down payment by way of a “gift.” In most cases the “gift” was added to the sales price, requiring repayment by the borrower.

Faced with an underwater mortgage, many times from day one, these homebuyers began defaulting at a rate three times higher than homebuyers with FHA loans without the seller-funded “gift.” In May 2006, the Internal Revenue Service (IRS) issued a ruling putting the charities on notice that this financing practice was not in line with IRS regulations.

The IRS began to investigate the estimated 300 organizations offering zero-down FHA loans; however, in 2007 FHA turned to the Administrative Procedures Act and began the rulemaking process required to prohibit the SFDPA programs.

At the start of FY 2008, FHA announced the SFDPA programs were no longer allowed in the FHA 203(b) program. It had been two years since the harmful nature of these loans had become apparent and FHA had been required to re-estimate its insurance fund by $6 billion due to the high default rate of SFDPA loans.

In October 2007, just days after the FHA announcement barring the SFDPA programs, FHA was sued in Federal Court by two of the charities. The Courts required FHA to continue accepting SFDPA loans until the case could be heard.

In early 2008, the Courts ruled against HUD, citing the HUD-produced report that served as a basis for SFDPA elimination. Fearing an end to their programs, the gift down payment groups increased their business and became one-third of FHA's entire book of purchase loans. In 2007, more than 42 percent of all FHA purchase loans in Texas used the SFDPA program — and Texas was home to the top five counties for FHA volume in the entire country.

Given the proliferation of the SFDPA programs, the health of the FHA mortgage insurance fund grew increasingly bleak. It became clear that the fund was going to require a first-ever Congressional appropriation at the start of FY 2009 if the SFDPA programs were allowed to continue. This dire projection was shared with staff from both the House and Senate appropriations committees.

In an effort to better price for risk on some mortgages, including those mortgages to borrowers who used SFDPA, FHA announced it was going to implement risk-based pricing on its mortgage insurance premiums. In recognition of the fact that its traditional "one size fits all" approach on premiums was no longer working, after a public comment period, FHA's risk-based pricing went into effect in mid-2008.

Because some industry organizations were not supportive of risk-based pricing, the Senate decided to place a one-year moratorium on the implementation of FHA risk-based pricing. The Senate concurred and levied FHA with one-year prohibition on pricing its mortgage insurance premiums based on the risk presented by the borrower.

FHA was running out of options to bolster its insurance fund and remain solvent. FHA staff was very aware that any tightening of existing credit policies would restrict access to FHA and, in the middle of a housing crisis, would not be viewed favorably by Congress or the American public.

Despite its uncertain financial health, FHA launched *FHASecure* in September 2007 to help address the industry's rising defaults and foreclosures. The product was designed to encourage subprime borrowers facing interest rate resets to refinance with an FHA mortgage. The product later was expanded to help borrowers already delinquent on their mortgage payments. *FHASecure* refinanced more than 525,000 at-risk borrowers in its 15 months of existence.

The Housing and Economic Recovery Act of 2008 (HERA) created the *Hope for Homeowners* (H4H) program that was designed to assist borrowers who owed more on their mortgages than the value of the homes. This program was considered flawed by many lenders and servicers from the outset because the insurance premiums were too high (3 percent up-front; 1.5 percent annual), the shared appreciation feature was overly prescriptive, extinguishing second lien mortgages proved difficult, and the various borrower/lender certifications made lenders apprehensive about using the program. Volume in the program was low.

HERA also increased the required down payment on FHA mortgages to 3.5 percent (up from 3 percent.) This coincided with FHA's raising the insurance premiums to 1.75 percent (up from 1.5 percent) when the Senate outlawed risk-based premium pricing.

With the passage of HERA, Congress finally turned off the SFDPA pipeline. The enormous number of SFDPA loans already within the FHA portfolio still could drag the FHA reserve fund even lower, especially if house prices continue to decline, but there are no more of these loans being added to the portfolio.

This point is not lost on the 2009 FHA actuarial contractor who noted in the recent audit "if the FHA had not insured any loans with seller-funded down payment assistance, the net capital ratio today would still be above the statutory required two percent… [and]… FHA's estimated economic net worth would be $10.4 billion higher today were it not for those loans."[12]

FHA's Actuarial Outlook

With the 2009 independent actuarial review showing that FHA's capital reserves had fallen below the required two percent level to 0.53 percent, FHA began to implement several initiatives designed to drive up borrower quality, eliminate poor performing lenders from its ranks and better manage risk.

While the drop in capital reserves received widespread coverage, a detailed explanation of the accounting FHA uses to compute its reserves did not, nor did the reasons for the decline. Although some people attempted to promote the idea that fraudulent lenders were to blame, the notion that they alone caused the drop in capital reserves is overstated. It is probably fair to say that the FHA

12 *Annual Report to Congress Regarding the Financial Status of FHA Mutual Mortgage Insurance Fund,* U.S. Department of Housing and Urban Development, (Nov. 12, 2009).

program, like many public programs, attracted its share of fraudulent activity designed to create monetary gains for the perpetrators.

Of note, the FHA actuarial review stated, "The severe decline [in the reserve fund] is mainly due to the current severe housing market decline and extremely stressful economic conditions." Further, "due to a near nationwide decline in house prices, this number reflects a sizeable, but not unexpected drop from last year's level."

FHA derives the capital reserve amount by using the following formula:

$$\textbf{FHA Capital Reserves (Ratio)} = \frac{\textbf{Economic Value of the Fund}}{\textbf{Dollar Value of Insurance-In-Force}}$$

The Economic Value of FHA Portfolio (the numerator) has been decreasing in relative terms for more than two years, especially the 2003-2007 loan cohorts. Concurrently, the Total Number of Homes in the FHA Portfolio (the denominator) also known as the Insurance-in-Force has been increasing — thus the eroding level of reserves.

It is not widely known that FHA has two reserve accounts: the financing account and the capital reserve account. The financing account holds an amount of funds needed to pay losses on existing loans over their 30-year term. The capital reserve account holds a separate reserve over and above the amount in the financing account. Together, both accounts hold $31 billion in total reserves — more than 4.5 percent of insurance-in-force.[13]

These salient points are offered as a cautionary note that FHA needs to be mindful of the root causes of its current actuarial dilemma, which go far beyond its tightening of credit and new risk management proposals. Principally, the root causes are the eroding economic value of the loan portfolio fueled by a sluggish economy and high unemployment as well as the proliferation of SFDPA loans during a 10-year period. Over-correcting the 203(b) program by imposing stricter credit requirements or higher cash investments could potentially turn-away the very borrowers FHA was designed to help, especially those looking for a refinance lifeline.

---

13 *Federal Housing Administration Single Family Mutual Mortgage Insurance Fund Programs; Quarterly Report to Congress Fiscal Year 2010, Quarter 3,* U.S. Department of Housing and Urban Development (Aug 2, 2010).

Given the ongoing economic uncertainty, other recently announced initiatives, such as the reduction in seller concessions from six percent to three percent, revamping the appraisal process, retooling the streamline refinance product, creating the position of Chief Risk Officer, and increasing overall lender enforcement are timely and appropriate. Taken together, these initiatives will help ensure FHA's continued viability as a critical participant in the housing market recovery. Additional staff provided for in the 2010 and 2011 budgets also will allow FHA to fill critical positions and expand staffing levels in other key areas including lender approval and compliance monitoring.

The ripple effect of this tightening will more than likely generate additional FHA receipts that will help off-set HUD's overall budget appropriation. House price assumptions and forecasts for the next several years are more optimistic than in years past and should help keep FHA in the black (although there are opinions to the contrary). In fact, the 2011 HUD budget request estimates that FHA will generate more than $5.7 billion in surplus receipts over and above what it needs to pay for claims — an enormously high level not seen in many years.

Has the Pendulum Swung Too Far?

For decades, the hallmark of FHA has been borrowers with low credit scores, spotty credit and limited funds for a down payment. Historically, the average credit score for FHA mortgages has been in the 620-660 range. Serving these borrowers is the principal reason FHA exists. Traditionally, these borrowers have been underserved and lacked sustainable homeownership opportunities and often they have been minority homebuyers.

Starting in January 2008, when the average credit score was 621, scores began a steady move upward. In every subsequent month except one, the average credit score rose — reaching 689 by September 2009.

Of note, the percentage of minority borrowers who access FHA has been dropping since FY 2006. In FY 2006, the level of minority participation in FHA was more than 30 percent. In FY 2009, that level dropped to 24.4 percent. While in real numbers, total originations of FHA loans to minority borrowers skyrocketed in this same time period, it is a possible cause for concern that the percentage has fallen to its lowest level in years. For decades, minority homeowners relied on FHA, making it the largest mortgage product in the nation for minority homebuyers.

As FHA moves to eliminate the “mini-Eagle” and possibly shrink its ranks of loan correspondents, there are many unanswered questions about the future of FHA and the delivery of mortgage services, especially in low-to-moderate and minority communities. The new net worth requirements of up to $2.5 million within three years may do little to mitigate fraud and perhaps only drive-away smaller mortgage companies many of which serve smaller, underserved communities.

FHA’s recent proposal to require a 10 percent down payment for loans with a credit score below 580 probably will have the effect of causing no loans to be originated for FHA with credit scores below 580. Moreover, very few lenders would be willing to approve a loan with a credit score below 580 regardless of FHA’s guidelines.

FHA Reverse Mortgage Outlook

For the second year in a row, FHA’s Reverse Mortgage product known as HECM is faced with a needed appropriation or further reductions in the Principal Limit Factor (PLF) caused by the on-going nationwide decline in house prices. The PLF is the amount of money the borrower is eligible to receive, subject to various criteria. As a result of pessimistic house price assumptions, the HECM’s credit subsidy rate for FY 2011 will be positive and require at least a $150 million appropriation.

By its design, the HECM program relies on house price appreciation to remain actuarially sound. In practice, the United States has typically enjoyed year-to-year house price appreciation in the aggregate. Historically, when areas of the country were experiencing zero price growth or worse, house price depreciation, other more economically stable regions of the country were able to offset the deleterious effects of house price depreciation on FHA’s insurance fund. In most years, the HECM program created millions of dollars in surplus receipts for the U.S. Treasury. However, due to the post-2007 housing market and its on-going negative or flat price assumptions, FHA will again need an appropriation or make further program modifications. Beyond the actuarial concerns, the HECM may also require extensive structural changes including the insurance premiums, participant counseling to include an individual financial assessment and whether or not escrow should be required. The lack of escrow has led to an increase in “tax and insurance” defaults with lenders apprehensive about foreclosure and adverse publicity.

In FY 2009, FHA instituted a 10 percent reduction in the PLF which eliminated most of the proposed $798 million appropriations requirement. On the surface, this seemed like a prudent and fiscally responsible move, however, the reduction in proceeds has contributed to the near flat, if not negative, growth in the program following years of steady volume increases. One reverse mortgage lender estimates this change has caused a 20-25 percent drop in HECM transactions.

Along with further house price declines, which will eventually impact the amount of proceeds a mortgagor can receive, the PLF reduction has severely curtailed growth in the program, despite the growing numbers of "Baby Boomers" who have become retirement eligible.

A Pivotal Year for the HECM Program

Beyond the appropriations concern and possible further reductions in the PLF, the HECM product has, at its core, an essential social purpose. Even as the public discourse around actuarial soundness and fraudulent activities in the program continues, there is no escaping the fact that the HECM product helps address a growing concern: how can we better ensure that one segment of the nation's senior population can age in place in a comfortable and secure environment?

FHA is required to determine its actuarial soundness through estimates and forecasts of the future economic value of the portfolio. Given the enormous level of social importance of this determination, perhaps FHA should assess whether or not this is the best way to determine its perceived economic health. This method is potentially problematic if the ripple effect of more pessimistic forecasts leads to even more programmatic constraints that make the HECM product so expensive and complex that seniors question its viability and affordability.

Concurrently, the need for affordable housing for seniors will continue to grow dramatically - especially among low- to middle-income seniors.

FHA Multifamily Background

When FHA was established in 1934, its mission to create affordable housing for low-to moderate-income Americans was designed to include support for multifamily rental housing as well as for single family housing. Within the Office of Housing, FHA administers the insured, non-rent-subsidized multifamily programs. Independent of the Office of Housing, the OIHCF administers FHA programs for senior housing as well as healthcare, hospitals and long-term care facilities.

FHA insures financing for multifamily development and the families who occupy the units in these properties generally receive no subsidies toward housing costs. The most popular multifamily and healthcare FHA programs are:

1. Financing for new construction or substantial rehabilitation of rental or cooperative housing (221 (d) (3) & (4));
2. Financing for the purchase and refinance of multifamily projects (223(f));
3. Financing for construction and rehabilitation of nursing homes and assisted living facilities (232);
4. Financing for multifamily housing projects in urban renewal areas, code enforcement areas, and other areas where local governments have undertaken designated revitalization activities (220).

The FHA multifamily and healthcare program loans are securitized in Ginnie Mae commercial mortgage-backed securities (CMBS) guaranteed by the full faith and credit of the United States government. The liquidity generated by the U.S. guarantee contributes to the low-cost funding and affordable lending in the multifamily arena as it does for the single family industry.

Today, the use of FHA multifamily insurance programs has been increasing. During the first six months of its FY 2010, FHA refinance and new construction/substantial rehab programs have insured over 300 percent more in loan amounts than in FY 2009. Meanwhile, the multifamily finance activity of the GSEs in their first quarter (calendar year 2010) has dropped by nearly 50 percent from the first quarter 2009. Already in FY 2010 (Oct 1, 2009 — Jun 10, 2010), FHA multifamily insurance commitments have exceeded $11.25 billion. The chart below compares basic FHA insurance and risk-sharing products it has issued and reissued with Freddie Mac and Fannie Mae (calendar year) volume:

	Volume	FHA	Freddie Mac	Fannie Mae
FY 2009	805 mortgages	$6.7B	$16.6B	$19.8B
FY 2008	637 mortgages	$3.7B	$24B	$35.5B
FY 2007	846 mortgages	$4.2B	$22B	$60B
FY 2006	1155 mortgages	$5.9B	$28.8B	$34.4B
FY 2005	1027 mortgages	$5.4B	$26.2B	$25.6B

* *Above data from Freddie Mac, Fannie Mae, and Department of Housing and Urban Development.*

While the FHA Single Family Insurance Fund has felt the impact of declining house prices and what turned out to be overly optimistic house price assumptions, the General Insurance/Special Risk Insurance Fund is administered differently and thus remains relatively stable with a manageable level of claims. Nonetheless, the multifamily portfolio has been impacted by the overall oversupply of housing, the sluggish economy, decreased property values and the ripple effect of uncertainty within the multifamily property market.

Seeking to proactively manage these risks, FHA has announced a series of risk mitigation initiatives. These are led by tighter underwriting, and in Mortgagee Letter 2010 21, they have taken the steps to revise underwriting standards, enhance verification of property financial performance, expand borrower mortgage credit analysis and pre-screen proposals from the significant increase of requests for multifamily mortgage insurance. Following the finance industry's efforts the past two years to slow the availability of credit to rental housing, this overall tightening of credit is being carried out as part of the initiatives in the FHA Commissioner's risk management plan for both multifamily housing and single family home mortgage programs. The recent "target and tighten" initiative as it's been called, focuses on 1) tightening underwriting and risk management requirements; 2) expediting new loan processing and standardizing application procedures; and 3) instituting new key performance measures and standards for qualifying lenders and underwriters.

Specific underwriting modifications for multifamily loans include:

- Defining sustaining occupancy as 90 percent physical occupancy and 85 percent economic occupancy for six months prior to application; maximum underwriting occupancy is 93 percent.
- Raising the minimum DSCR to 1.20 percent for market-rate projects.
- Raising the minimum DSCR to 1.15 percent for projects meeting an expanded definition for affordable housing including subsidy levels of 90 percent and projects that also use the Low Income Housing Tax Credit.

Multifamily and single family rental vacancy rates are currently near all-time highs, evidence of significant oversupply of housing in the U.S. Regional variations, however, coupled with the long lead time for development of multifamily properties, present opportunities for prudent development in many communities. In coming years, FHA will need to carefully balance considerations regarding the supply, demand, affordability and profitability of multifamily properties and its ability to balance these sometimes competing priorities. FHA's insurance programs remain important tools in meeting both the need for affordable rental housing and the gaps in credit needed to maintain it.

It is important that the industry supports FHA's insurance programs to meet both the need for rental housing as it should grow, and the gaps in credit for multifamily properties which hopefully will decline with time. MBA's Multifamily Council has articulated a set of priorities for 2010 that support the increased viability for FHA's multifamily programs and increased authority to the FHA Commissioner and HUD Secretary. Top among MBA's priorities for the multifamily finance industry is seeing that steps are taken to make FHA's multifamily programs as viable as the market needs them to be. MBA will:

- Assure the future of FHA is addressed as legislation advances on the future of the GSEs and the government's role in housing.
- Provide support for FHA multifamily and healthcare programs with HUD senior management and Congress to assure adequate staffing and funding for technology and contractors.
- Assure that FHA remains a viable financing vehicle for both market rate rental housing and affordable rental housing.
- Work with HUD's Office of Housing staff to implement the list of FHA priorities to improve processing times and streamline processes.
- Work with OIHCF staff to achieve better communication of changes to programs under LEAN and to develop best practices.

Ginnie Mae

The past two years have provided Ginnie Mae with an opportunity to serve the markets during a difficult time. It rose to the challenge and exceeded the expectations of a market in dire straits. The volume of Ginnie Mae MBS issued in FY 2007 was $85 billion; in FY 2008, $220 billion; and FY 2009, $418.9 billion. Through the first four months of 2010, Ginnie Mae was on track to exceed its 2009 issuance total.

In addition to the explosion in Ginnie Mae's MBS issuance volume, the agency's revenues and net revenues were substantial. During FY 2008 and FY 2009, revenues exceeded expenses by $1.4 billion — a sizable return to the federal government. The agency's portfolio of MBS grew to $825 billion by the end of FY 2008 and its net worth grew to almost $15 billion with approximately $14 billion in liquid treasury securities. There is every indication that Ginnie Mae will remain profitable in 2010 with its portfolio expected to reach $1 trillion.

The Ginnie Mae security is the only MBS with payments to investors backed by the full faith and credit guarantee of the U.S. government. The Ginnie Mae MBS also have a zero percent risk weighting in bank portfolios while Fannie Mae and Freddie Mac MBS have a 20 percent risk weighting. Applications for new issuers were up threefold from FY 2008 to FY 2009 with 37 new issuers approved.

Ginnie Mae Response to the Housing Market Crises

In response to the various government initiatives designed to stabilize and support the financial and housing markets, Ginnie Mae has designed new programs and modified existing programs. As the federal government implemented mortgage programs, often their success was dependent on the existence of a secondary mortgage market. In particular, the government guarantee was essential to creating a liquid market for Ginnie Mae securities backed by modified mortgages, mortgages with increased loan limits, and 40-year mortgages.

HERA authorized the H4H program that became effective on October 1, 2008. It was designed to help homeowners facing foreclosure refinance any existing conventional or government insured or guaranteed mortgage into an FHA-insured mortgage. One month later, Ginnie Mae was ready to accept H4H loan products in Ginnie Mae II MBS. As of February 2009, issuers can pool the 40-year H4H mortgages into a new 40-year multiple issuer pool.

When FHA mortgage loan limits were increased, allowing FHA to meet the needs of homebuyers and homeowners in high-cost areas, Ginnie Mae expanded the eligibility requirements in Ginnie Mae II securities to allow for inclusion of these higher balanced mortgages.

Today, Ginnie Mae securities allow these mortgages to be eligible in the To Be Announced (TBA) market as long as such loans do not exceed 10 percent of the balance of the MBS.

To manage potential risks involved in its expanded role, Ginnie Mae also has put enhanced risk management procedures in place. Issuer oversight has been expanded. Since October 1, 2008, new issuers had to demonstrate a net worth of $1 million. This is up from a previous minimum net worth requirement of $250,000. Existing issuers have until October 1, 2010 to meet this new requirement.

In addition to higher net worth requirements, issuers will face tougher scrutiny around their capabilities and performance servicing Ginnie Mae portfolios. In FY 2009, Ginnie Mae created a Special Servicer Review program to provide onsite reviews of issuers deemed to pose a potential risk to Ginnie Mae. In concert with FHA, Ginnie Mae will impose sanctions when necessary to stop irresponsible lending practices, mitigate taxpayer losses and preserve the integrity of the mortgage markets.

Ginnie Mae Going Forward

The future of the secondary market has become the subject of much deliberation among industry leaders and policymakers and MBA expects its intensity to increase over the next year. In March 2010, Congressman Barney Frank (D–MA), Chairman of the House Financial Services Committee, began hearings on the future of Fannie Mae and Freddie Mac and their role as secondary market vehicles. These quasi-government agencies have been an enormous component of our nation’s mortgage market; however, as the nation learned during the past two years, America cannot rely solely on Fannie Mae and Freddie Mac to provide the liquidity the mortgage markets need.

MBA has done extensive work surrounding the future of the secondary market. MBA released a report in January 2009 entitled, “Key Considerations for the Future of the Secondary Mortgage Market and the Government Sponsored Enterprises (GSEs)” and in March 2009, MBA released a set of guiding principles embodying the key considerations discussed in the January report. The principles, outlined in “Principles for Ensuring Mortgage Liquidity,” serve as a valuable tool in evaluating proposals for restructuring the secondary market. In September 2009, after considerable discussion and deliberation, MBA presented "Recommendations for the Future Government Role in the Core Secondary Mortgage Market," a suggested framework for government involvement in the single family and multifamily secondary mortgage markets, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac.[14] These recommendations established a foundation for the current debate and have been integrated in many of the proposals that have since come forward.

The future role and structure of Ginnie Mae must be included in this debate. Ginnie Mae has been, and will remain, the primary secondary market outlet for FHA, VA and USDA rural housing loans. MBA views these programs as key to fulfilling several U.S. housing policy goals, including the provision of affordable housing finance to first-time homebuyers and other groups underserved by the private market. Hence, Ginnie Mae's role is also indispensable in fulfilling these goals. We must take measures now to ensure that Ginnie Mae remains a viable component of the housing finance system.

14 See www.mortgagebankers.org/CEML for these documents and others related to MBA's work on the future of the secondary mortgage markets.

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

1717 Rhode Island Ave., NW, Suite 400
Washington, DC 20036