December 2, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: "An Examination of the Federal Housing Administration and Its Impact on Homeownership in America"

The Subcommittee on Housing, Community Development and Insurance will hold a hearing at 2:00 p.m. on Thursday, December 5, 2019, in room 2128 of the Rayburn House Office Building. This hearing will examine the role that the Federal Housing Administration (FHA) plays in the nation's housing finance system, and proposals to improve FHA's ability to promote access to homeownership, particularly for underserved borrowers.

This hearing will have one panel with a single witness:

- **The Honorable Brian Montgomery**, Commissioner, Federal Housing Administration

Background

FHA is an agency within the Department of Housing and Urban Development (HUD) that was created in response to the failure of the banking system during the Great Depression to help stabilize the housing market and the larger economy.[1] FHA provides insurance on qualifying mortgages on single-family and multifamily loans, including loans for manufactured homes and reverse mortgages. Today, FHA manages the largest mortgage insurance portfolio in the U.S. mortgage finance system with single-family insurance in force for FY 2019 totaling nearly $1.3 trillion.[2]

FHA is designed to play a counter-cyclical role in the housing market, meaning that its market share expands when the private market recedes, such as during a recession, and decreases when the private market is strong. This helps provide long-term stability to the housing market, particularly during stress events. For example, during the most recent housing crisis, FHA's market share expanded to fill the gap left by the private sector, helping to keep mortgage credit available for families across the country. Moody's Analytics estimated that in 2011 alone FHA prevented home prices from dropping an additional 25 percent, which would have cost three million jobs and

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[1] 12 U.S. Code § 1701 (1934).
[2] Department of Housing and Urban Development (HUD), "Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund." 2019.

sent our economy into a double-dip recession.[3] Since then, FHA's market share has generally been receding as the private market has regained its strength.[4]

FHA also plays a role in expanding access to homeownership among households who could have difficulty obtaining a mortgage from the private market, including minority, first-time, and low-income homebuyers. According to HUD, in FY 2019:

- First-time homebuyers represented approximately 83 percent of all FHA forward mortgage purchase transactions;
- Minority borrowers represented 33 percent of all FHA forward mortgage transactions (18 percent Hispanic, 13 percent Black, 2 percent Asian, and 0.3 percent American Indian);
- Approximately 60 percent of Home Equity Conversion Mortgage (HECM) endorsements are to single borrowers, who tend to be at lower income levels than non-single borrowers

FHA's Financial Health

FHA operates almost entirely from its self-generated income held in the Mutual Mortgage Insurance Fund (MMIF). The MMIF insures mortgages made by FHA on single-family homes through its single-family mortgage guarantee program and the HECM program. The MMIF consists of two primary accounts: the financing account and the capital reserve account. The financing account is designed to hold sufficient funds to make the expected future payments needed to satisfy FHA's single-family mortgage guarantees. The capital reserve account holds additional funds, which are available to cover unexpected losses on those guarantees. The MMIF is funded primarily from mortgage insurance premiums (MIPs) and from the sales of foreclosed properties. This revenue is also used to offset annual appropriations for the rest of HUD's programs.

One of the key ways to measure the health of the MMIF is to look at the capital ratio. The capital ratio is calculated by taking the economic net worth[5] of the MMIF divided by the total dollar amount of loans currently insured under the MMIF (or "total insurance-in-force"). HUD is statutorily required to ensure that the MMIF maintains a capital ratio of 2 percent at all times.[6] A negative capital ratio indicates that that FHA will not be able to cover expected losses over the life of the mortgages it currently insures under current projections. In the rare case of an increase in expected future losses that cannot be covered by the capital reserve account, FHA has authority to draw from the Treasury without additional congressional action. This authority applies to federal credit programs broadly and is not unique to FHA. FHA has only used this authority once in the aftermath of the 2008 crisis.

According to the FY 2019 Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund released on November 14, 2019, the economic condition of the MMIF has been improving for the past several years and continued its strong

[3] Moody's Analytics, "The FHA Admirably Fills the Void," Jan. 7, 2014.
[4] HUD, Supra Note 2.
[5] The economic net worth or "MMI Capital" is calculated by taking the total capital resources plus the net present value of all future cash flows from the mortgages currently insured. 12 U.S.C. §1711(f)(4)
[6] 12 U.S.C. § 1711(f)(4)

trajectory, with increases in both the capital ratio and the total Economic Net Worth. The capital ratio increased from 2.76 percent in FY 2018 to 4.84 in FY 2019, the highest level since FY 2007. The Economic Net Worth nearly doubled, increasing from $35 billion in FY 2018 to $62 billion in FY 2019. FHA's cumulative Insurance-in-Force (IIF) reached nearly $1.3 trillion of Unpaid Principal Balance (UPB). Serious delinquency rates for FHA mortgages have generally declined since the 2008 financial crisis and decreased from 4.11 percent at the end of FY 2018 to 3.88 in FY 2019.

FHA Policy Changes Under the Trump Administration

Suspension of Premium Decrease. Immediately following President Trump's inauguration, HUD issued an administrative order that suspended a planned quarter-point decrease in annual FHA insurance premiums for most FHA-insured mortgages.[7] This premium cut was projected to save prospective FHA borrowers an average of $500 in the first year alone. While, this change was made prior to Secretary Carson's official start date at HUD, he has maintained this suspension indefinitely and defended the decision despite the strong financial health of FHA's MMIF and calls from advocates and stakeholders to lift the suspension. According to research from the National Association of Realtors, between roughly 234,000 creditworthy borrowers were priced out of the homebuying market in 2014 solely due to FHA's high premiums.[8]

Prohibition on Eligibility of DACA Recipients. In December 2018, BuzzFeed reported that recipients of Deferred Action for Childhood Arrivals (DACA) were being denied FHA-backed mortgages.[9] While HUD has claimed that its policies surrounding DACA recipients has not changed, FHA-approved lenders that work with DACA borrowers maintain that DACA recipients were previously approved but are now being denied by FHA.[10]

Termination of FHA-FFB Partnership. HUD's Budget Request for FY 2019 indicated without any explanation that HUD would be winding down FHA's partnership with the Federal Financing Bank (FHA-FFB Partnership) by honoring existing commitments but refusing to take on new commitments in 2019.[11] The FHA-FFB Partnership [12] had been in place since June 26, 2014 and supported affordable housing preservation and construction by providing low-cost financing for multifamily risk-share loans that are originated by state and local housing finance agencies.

Failure to Address Concerns with the Distressed Asset Stabilization Program (DASP). In July 2017, HUD's Office of Inspector General issued a report criticizing HUD for failing to engage in formal rulemaking for DASP. HUD responded by putting out an advance notice of proposed rulemaking but has yet to follow through with a proposed rule. In July 2019, the GAO released a

[7] HUD Mortgagee Letter 2017-07, Jan. 20, 2017.
[8] National Association of Realtors, "Lowering Federal Mortgage Fees is the Right Move." 2015.
[9] BuzzFeed News, "The Trump Administration Is Quietly Denying Federal Housing Loans To DACA Recipients." 2018.
[10] HousingWire, "HUD declares FHA is no longer backing DACA mortgages." 2019.
[11] *See* footnote 2 on p. 26-12 of HUD's Congressional Justification for its FY 2019 Budget Request for the FHA-Mutual Mortgage Insurance Fund.
[12] U.S. Department of the Treasury, "Secretary Lew Unveils New Efforts to Assist Struggling and Prospective Homeowners, Provide More Affordable Options for Renters," June 26, 2014.

report that found several deficiencies in FHA's management of DASP, including a failure to appropriately evaluate outcomes for loans to determine whether program goals are being met.[13] None of the recommendations in that report have been closed out.

HUD's Housing Finance Reform Plan

On March 27, 2019, the Trump Administration released a memo, directing Treasury Secretary Mnuchin to develop a plan for reforming Fannie Mae and Freddie Mac (the Enterprises) and directing Department of Housing and Urban Development (HUD) Secretary Carson to develop a plan for reforming Ginnie Mae and the Federal Housing Administration (FHA). On September 5, 2019, Treasury and HUD responded to that memo with their respective plans. HUD's plan focused on both legislative and administrative recommendations affecting FHA and Ginnie Mae.

Under the legislative recommendations in HUD's plan, FHA would be restructured as an autonomous government corporation within HUD. It is unclear how this would affect the budgets of FHA and HUD. However, given that HUD's plan states that this would "provide the agency tools and resources necessary to make appropriate risk decisions to respond to changing markets," this could also include eliminating or decreasing the offsetting receipts that FHA currently provides for the overall HUD budget. As explained earlier, FHA receipts currently help offset the cost of other HUD programs so allowing FHA to keep more of its receipts would increase the amount of funding that Congress needs to appropriate for other HUD programs to maintain current funding levels.

Many of the administrative recommendations in HUD's plan are aimed at limiting FHA's role in the housing finance system. For example, HUD recommends that FHA adopt a risk-based capital regime that is above the statutory 2 percent capital ratio as well as a risk-based pricing system wherein higher risk loans would be charged higher premiums. Currently, FHA generally applies a flat premium level, and stakeholders have raised concerns that moving to a risk-based pricing system would prevent FHA from serving the underserved borrowers that it is intended to serve.[14] HUD also recommends coordination with FHFA to avoid overlap between the Enterprises and FHA.

HUD includes several other legislative recommendations to enhance its systems, enforcement, and oversight, including: enhancing FHA's authorities to manage lender counterparty risks, increasing funding for technological improvements to FHA's single family and multifamily operations, and authorizing the subordination of any Property Assessed Clean Energy (PACE) liens on existing FHA loans.

Legislative Proposals

- H.R. 3958, the "FHA Foreclosure Prevention Act of 2019," introduced by Chairwoman Waters would enhance FHA's oversight of loss mitigation and establish a complaint and appeals process for borrowers who believe their servicer is out of compliance with FHA's servicing requirements.

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[13] GAO, "Federal Housing Administration: Opportunities Exist to Improve Defaulted Single-Family Loan Sales," Jul. 2019

[14] *See e.g.* Community Home Lenders Association letter to HUD Secretary dated Oct. 8, 2019.

- H.R. ____, the "Improving FHA Support for Small Dollar Mortgages Act of 2019," would require FHA to conduct a review of its policies to identify any barriers to supporting mortgages under $70,000 and report to Congress within a year with a plan for removing such barriers.
- H.R. ___, the "Reinstating the FHA-FFB partnership Act of 2019," would require HUD to continue the FHA-FFB partnership.
- H.R. ___, the "Helping Borrowers Avoid Foreclosure Act," would provide FHA and the U.S. Department of Agriculture with authority to offer enhanced loss mitigation options for distressed borrowers.
- H.R. ____, the "Improving Federal Oversight of PACE Financing Act of 2019," a discussion draft from Representative Sherman, would require originators of Property Assessed Clean Energy loans to obtain the consent of the underlying single-family mortgage holder prior to origination.
- H.R. ___, the "Making FHA Work for Borrowers with Student Debt Act" is a discussion draft from Representative Meeks that would require that FHA allow lenders to consider actual monthly student loan payments based on current student lender documentation to account for borrowers who may have high student debt but are in income-based repayment plans.