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Introduction

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

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

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

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

Mutual Mortgage Insurance Fund

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

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

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

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

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

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

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

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

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

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

Housing Finance Reform

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

Providing Regulatory Clarity to FHA Lenders

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

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

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

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

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

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

Information Technology

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

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

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

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

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

Servicing

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

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

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

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

Reverse Mortgages

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

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

FHA Risk Management

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

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

Multifamily Housing

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

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

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

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

REAC/NSPIRE

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

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

Office of Healthcare Programs

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

Office of Housing Counseling

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

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

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

Office of Manufactured Housing Programs

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

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

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

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

Conclusion

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