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Office of Housing
U.S. Department of Housing and Urban Development
House Committee on Appropriations
Subcommittee on Transportation, Housing and Urban Development, and Related Agencies
April 25, 2018

Introduction

Chairman Diaz-Balart, Ranking Member Price, and members of this Subcommittee, thank you for inviting me here today to discuss the President's Fiscal Year (FY) 2019 Budget request for the U.S. Department of Housing and Urban Development's (HUD) Office of Housing and Federal Housing Administration (FHA). As a former Congressional staffer, including working on both the House Budget Committee and the Senate Appropriations Committee, I have great respect for the role Congress has in setting the budget and providing oversight of government spending.

HUD, through the Office of Housing, works to maintain strength and stability in our nation's housing markets. The Office of Housing is the largest office within HUD, and has the following key responsibilities:

- Operating FHA, which is the world's largest mortgage insurer, providing over $1.3 trillion in mortgage insurance for Single Family, Multifamily, and Healthcare loans;
- Managing HUD's Project-Based Rental Assistance (PBRA) and other rental assistance programs, which provide support for low-income and very low-income households;
- Managing the Housing for the Elderly (Section 202) and Housing for Persons with Disabilities (Section 811) programs, which provide support for some of our nation's most vulnerable populations;
- Supporting recapitalization of the nation's aging affordable housing stock through programs like the Rental Assistance Demonstration (RAD);
- Facilitating housing counseling assistance through HUD's Office of Housing Counseling; and
- Operating HUD's Manufactured Housing Program, which administers federal standards for the design and construction of manufactured homes across the country.

The Office of Housing plays a critical role in fostering affordable housing for individuals and families who need it the most. In addition, for 83 years, FHA has provided opportunities for Americans to build equity through homeownership and climb the economic ladder of success.

To achieve these objectives, we must operate programs that are sustainable for borrowers, renters, and taxpayers. Over eight million mostly first-time and low-to-moderate income homeowners count on FHA. HUD's Multifamily rental properties provide over 2.5 million affordable rental units, and FHA provides mortgage insurance for over 3,600 hospitals and residential care facilities.

Importantly, taxpayers stand behind everything we do, including FHA's book of business. This is a responsibility that demands prudent management of our programs.

To that end, the priorities reflected in our funding request for FY 2019 include the following:

- Developing a stable risk management and technology platform to ensure continuity of our operations and avoid financial losses;
- Providing more transparency, consistency, and accountability to the American public on FHA's book of business;
- Managing our credit box to ensure that sustainable loans are made to those who have an ability to repay them;
- Maintaining FHA's Multifamily platform to ensure access to safe and affordable rental housing;
- Providing more certainty to lenders and other private sector partners when it comes to FHA's policies, rules, and enforcement;
- Reforming our rental assistance programs to streamline administration, increase local flexibility, improve fiscal sustainability, and encourage resident self-sufficiency while protecting currently-assisted elderly and disabled households from adverse impacts;
- Expanding programs like RAD that allow HUD to recapitalize aging housing stock and improve the quality of life for tenants; and
- Reducing undue regulatory burdens across programs, consistent with the President's Executive Orders.

In addition to these FY 2019 priorities, the Office of Housing has proven that, when times demand it, it plays a vital role supporting American families through both economic downturns and natural disasters.

Disaster Recovery

The devastating natural disasters in 2017, including Hurricanes Harvey, Irma, and Maria, as well as destructive wildfires in California, continue to have lasting impacts. We are grateful to the members of this Subcommittee for your leadership and support as we continue to work to aid the recovery in areas impacted by last year's natural disasters. As most of you know, HUD is the lead federal agency for long-term disaster recovery for housing, which includes administering grant funds to rebuild affected areas and to begin the recovery process.

More specifically, FHA immediately took action to assist families impacted by these events. We provided a 90-day moratorium for all foreclosures in disaster-impacted areas, which we have since extended. FHA requires loan servicers to make available forbearance of up to a year for impacted borrowers who, through no fault of their own, cannot make payments. We continue to provide access to loan modifications that are designed to reduce monthly payments and keep families in their homes.

Earlier this year, FHA rolled out a new and important tool to help delinquent borrowers cover missed mortgage payments through what is called a Disaster Standalone Partial Claim. This is an option aimed at borrowers who may have below-market interest rates and may not be suited for a loan modification. Through this new option, borrowers can keep their low interest rates and current mortgage terms without facing payment shock and added fees. Additionally, FHA streamlined the process for servicers to offer this and other forms of assistance in disaster-impacted areas, making it easier for borrowers to obtain.

FHA will continue to focus its efforts on providing maximum relief in disaster areas, while also managing its insured portfolio and exposure to losses. Given the billions of dollars of FHA-insured mortgages in disaster-impacted areas, we continue to monitor loan performance and expect increased losses, especially from loans originated in Puerto Rico.

For HUD Multifamily properties in the impacted areas, our staff has worked diligently to conduct onsite assessments for properties that reported moderate and severe damage because of Hurricanes Harvey and Irma. Our team also conducted onsite assessments on all 220 properties in FHA's portfolio in Puerto Rico and the U.S. Virgin Islands (USVI). Currently, all Multifamily properties in Puerto Rico and the USVI have had permanent electrical service through the power grid restored. In addition, HUD has worked to ensure continuity in monthly subsidy payments for properties that receive project-based assistance. We have also provided help to owners in submitting subsidy vouchers manually where there may be disruptions in internet access. We will continue to closely engage with property owners and managers as they develop longer-term recovery plans and to ensure that residents are receiving the assistance they need.

FHA Single Family Program

FHA's dual mission to support homeownership for underserved populations and provide countercyclical support must be balanced with its responsibility to ensure that the portfolio is financially and structurally viable. The Office of Single Family runs the largest and longest-running program at FHA – in fact, it predates HUD itself. FHA's traditional role is to provide mortgage insurance to lenders in order to make credit available to borrowers who may not be served by the conventional market. For FY 2019, the President's Budget estimates a volume of about $230 billion for forward mortgages, and about $12 billion for Home Equity Conversion Mortgages (HECMs), or reverse mortgages.

FHA's role in the housing market should be stable, reliable, and targeted. It is an important source of mortgage credit for first-time homebuyers, minority borrowers, and low- to moderate-income families. During FY 2017, more than 82 percent of FHA's Single Family purchase loans were for first-time homebuyers, and 54 percent of all loans were for low-to-moderate income borrowers. In addition, 33 percent of all FHA-insured mortgages served minority homebuyers during FY 2017.

FHA also has a role to play as a stable, countercyclical source of capital for the housing market during periods of economic distress. That is why we must take steps to ensure its viability for future generations of borrowers, especially during tough economic times. We must make sure FHA is facilitating sustainable loans borrowers can repay, putting in place strong risk management and good underwriting standards, and developing a sound technological platform to operate our programs.

Administrative Expenses and Information Technology Fee

The FY 2019 Budget requests $150 million in administrative expenses, an increase of $20 million over the enacted level for FY 2018, to support a range of FHA functions, including loan underwriting, claims processing, and risk monitoring. The requested funding increase will also support the modernization of Single Family information technology (IT) systems.

Updating FHA's legacy IT systems is a critical priority for this administration. To offset the increased appropriation, the FY 2019 Budget requests authority to collect from FHA lenders a fee of up to $25 per loan. This fee would apply on a prospective basis and expire after four years. The IT investments facilitated by the fee will enable FHA to address operational and financial risks posed by aging systems, become a more reliable resource for lenders and, by extension, better serve borrowers.

Currently, FHA's platform is built on a more than 40-year-old mainframe system that runs an obsolete programming language. The risk that this presents to FHA, and by extension to the American taxpayers, is significant. Not only is FHA's current IT system outdated, it is unreliable. There were 73 outages of FHA's origination systems during 2017, with durations lasting as long as five days.

Furthermore, FHA must have the ability to collect more comprehensive, robust data prior to endorsement, mirroring changes that Fannie Mae and Freddie Mac made over the last decade in response to the housing crisis. Moving to a system that allows FHA to conduct more robust analysis prior to endorsement will allow HUD to more effectively manage risk and provide more certainty to lenders participating in FHA programs.

Another goal as part of IT modernization is to move to a paperless endorsement process. Currently, 400,000 paper binders averaging 300 pieces of paper each are sent to FHA's regional Homeownership Centers each year, totaling 120 million pieces of paper. This costs us millions of dollars in storage, maintenance, and shipping, and presents a burden to the industry – which has been moving towards a paperless process for many years.

FHA simply cannot continue to operate antiquated systems that are highly expensive to maintain, are based on legacy programming languages planned for obsolescence, prevent lenders from accessing critical data, and regularly fail. Our budgetary request to upgrade technology is central to effectively managing risks to the Mutual Mortgage Insurance Fund (MMIF) and to protecting American taxpayers.

Financial Health of the MMIF

In its FY 2017 Annual Report to Congress on the financial status of FHA's Mutual Mortgage Insurance Fund (MMIF), FHA reported a capital ratio of 2.09 percent. While this is above the two percent statutory minimum for the third straight year, it is a decline from the FY 2016 level of 2.35 percent.

Ensuring the long-term financial viability of FHA is a top priority for Secretary Carson. One of the first actions this administration took was to suspend a decision by the previous administration to reduce FHA's Single Family Housing insurance premiums. Had the premium reductions taken effect, the MMIF capital ratio would have fallen below FHA's statutory minimum to 1.76 percent.

We are committed to more transparency of FHA's book of business. Last year's Annual Report to Congress reflected our desire to provide markets and the American public with a bigger window into the composition of our portfolio. We also strive towards more consistency, whether it be in how we report data or how we make policy decisions that markets depend upon. One action we took as part of FHA's annual report was to provide more information on the true, standalone condition of both Single Family forward and reverse mortgages.

Changes to the HECM Program

It was clear in our analysis that FHA's reverse mortgage portfolio, or HECM, continues to drain our capital. Since FY 2009, as measured in the 2017 Annual Report to Congress, FHA-insured HECMs have resulted in a net cost of $14.5 billion to the MMIF, and we cannot rule out the potential for further losses.

That is why we acted in October of last year to put new reverse mortgage business on an improved fiscal path. These steps included adjusting HECM insurance premiums and Principal Limit Factors. Principal Limit Factors determine the share of home value a homeowner can borrow against.

Historically, HECM is a financially volatile program that will continue to demand a watchful eye. FHA will do what is necessary to stabilize the program and, where possible, reduce what will likely be substantial losses to FHA from the legacy book of insured reverse mortgages. We must protect seniors who depend on HECM to age in place, while also ensuring that FHA's forward program and, ultimately taxpayers, do not have to bail out the HECM program.

Recent Actions and Performance Trends

We are also scrutinizing policies that do not necessarily fit into FHA's core mission and could increase risk for taxpayers.

For example, in December of 2017, FHA issued a Mortgagee Letter making clear that properties encumbered with Property Assessed Clean Energy (PACE) obligations will no longer be eligible for an FHA-insured mortgage. We took this action because PACE obligations represented a potential increase in losses for the MMIF due to the priority lien status of PACE obligations in the event of default. HUD remains concerned with PACE assessments that are placed on FHA loans *after* endorsement, and we are monitoring this practice to determine if further action is warranted. Taxpayers should never have another lien "jump ahead" of FHA and encumber the collateral that makes FHA insurance viable and affordable.

In addition, HUD continues to closely monitor several other trends in our Single Family insurance portfolio that could potentially increase claims against the MMIF. For example, in September and December of 2017, FHA's Single Family business saw an uptick in Serious Delinquencies (SDQs) as well as Early Payment Delinquencies (EPDs). While the hurricanes and seasonality were a major factors, some of this increase may be attributable to a decrease in mortgage credit quality. Indeed, lower credit quality is a concern for FHA because it hampers borrowers' ability to withstand adverse events such as economic downturns and natural disasters.

Furthermore, we continue to see an increase in the proportion of borrowers with debt-to-income (DTI) ratios above 50 percent. In February, the percentage of borrowers with FHA-insured mortgages with DTI ratios above 50 percent increased to 24.6 percent, up from 19.8 percent a year ago. The average DTI ratio for the entire Single Family portfolio increased from 42.7 percent in January to 42.9 percent in February, and up from 41.8 percent during the same time last year.

Two other areas to highlight are the rate of FHA-insured purchase transaction mortgages that have Down Payment Assistance (DPA), and the rise in cash-out refinance transactions. The number of purchase loans with some form of DPA now stands at about 40 percent, with certain categories of DPA carrying added risk. Cash-out refinances as a percentage of total refinances have risen from almost 38 percent in February of 2017 to almost 55 percent in February 2018.

While the credit performance of FHA's overall forward portfolio has generally been trending favorably, supported by exceptional home price appreciation and strong job growth, we must remain diligent in safeguarding sound credit standards and underwriting for new loans. For these reasons, we are carefully evaluating these trends and indicators of potential defaults to ensure that FHA mortgages are sustainable both for the borrower and the MMIF.

Lender Enforcement

Data has also shown a significant shift in the composition of lenders participating in FHA. Depository institutions now represent less than 15 percent of those originating FHA mortgages. In 2010, the number of bank lenders was closer to 45 percent.

Banks have cited that a reason for their limited participation in FHA is the legal liability associated with enforcement actions stemming from the False Claims Act. They have expressed concerns that minor errors could expose them to severe penalties. Secretary Carson has committed to reviewing and addressing these concerns with the Department of Justice, and both departments are now actively involved in discussions on this topic.

Additionally, FHA is looking at its defect taxonomy, which establishes defect categories and how FHA views the severity of each defect, as well as our own system of enforcement. It is worth noting the conventional mortgage market has made progress in addressing these issues, creating greater confidence to lend using the secondary market outlets available primarily through Fannie Mae and Freddie Mac.

FHA strives to be as clear as possible in its guidance on enforcement matters. We will not tolerate those who defraud borrowers and taxpayers, or make routine, material errors that put a strain on FHA's resources. In doing so, FHA must adhere to the Rule of Law, which means that FHA's view of materiality should be well-defined, transparent, and consistently applied. This will help FHA manage its own risk, too.

But in the case of immaterial errors, or where FHA has other sufficient remedies available, we have administrative processes within HUD that can and should be used for resolving many issues. The end goal is for every good lender who makes responsible loans to feel confident in participating in FHA programs – and, on top of this, for FHA borrowers to have many different access points to FHA-insured mortgage credit.

Multifamily and Healthcare Mortgage Insurance Programs

HUD is also a cornerstone for renters seeking safe and affordable housing. Multifamily programs aim to strengthen the quality and affordability of the nation's housing stock, while encouraging the use of private capital to offset risks to the American taxpayer.

Currently, the nation's aging Public Housing stock will cost over $26 billion in deferred maintenance. As Secretary Carson has testified, HUD is proposing a new strategy that will encourage Public Housing Authorities (PHAs) to pivot, over the medium-term, from the current financially unsustainable public housing model to other platforms that allow PHAs to function more like every other Multifamily building owner in America. We also believe encouraging states and localities to bring more resources to the table helps PHAs have the flexibility to make decisions at the local level that are best suited for the needs of their communities.

The Rental Assistance Program

The Rental Assistance Demonstration (RAD) is one of the most important tools HUD has to address the backlog of deferred maintenance. We appreciate all the work this Subcommittee has done to authorize and fund RAD. In particular, we are grateful to the provisions in the FY 2018 Omnibus Appropriations Act that both raised the RAD cap to 455,000 units and expanded RAD to include Section 202 Housing for the Elderly. These actions will allow HUD to use this platform to provide better homes and a better quality of life for the low-income and very low-income residents we assist.

RAD allows properties to shift from their current platform to the Section 8 program so that providers may leverage the private market to make capital improvements, enabling the properties to be preserved for long-term affordability. Since its initial launch in 2012, more than 280 PHAs have worked with HUD through RAD to generate over $5.4 billion in capital to rehabilitate and recapitalize over 91,000 former public housing units at revenue neutral rent levels.

The program has two components. The first component allows Public Housing properties to convert to long-term Section 8 rental assistance contracts. The second component allows properties currently operating under HUD's Rent Supplement, Rental Assistance Payment (RAP), Moderate Rehabilitation, Moderate Rehabilitation/McKinney Vento Single Room Occupancy (SRO), and, now, Section 202 Property Rental Assistance Contract (PRAC) programs to convert from their varied program structures to project-based assistance with long-term contracts.

RAD public housing conversions are limited by Public Housing funding levels and by statutory caps on the number of units that can be converted. Currently, a converting property's future per-unit rental assistance funding levels are based on its Public Housing funding levels. However, at current funding levels, some properties are unable to feasibly convert. In short, their future rental assistance funding stream would be too small to pay back the cost of rehabilitating the property.

The President's FY 2019 Budget includes $100 million for the RAD program to cover the incremental subsidy necessary for those properties to feasibly convert. If appropriated, HUD will do everything in its power to ensure these dollars are stretched as far as possible.

The President's FY 2019 Budget also supports eliminating the current 455,000-unit cap on conversions. Eliminating the cap will allow HUD to make RAD conversions available to all PHAs that have the ability to participate – without increasing the Department's expenditures.

Protecting Vulnerable Populations

The FY 2019 Budget reflects HUD's desire to work with PHAs and others to provide and preserve affordable housing for families in need and vulnerable populations. This includes the Budget's request of $11.1 billion to fully fund Project-Based Rental Assistance (PBRA) contracts, which provide rental subsidies for over 1.2 million low-income and very low-income households. In addition, the Budget requested another $600 million for the Section 202 Program that supports senior housing, and $140 million for the Section 811 program that supports housing for persons with disabilities.

HUD is very appreciative of the Committee's work on the Omnibus and your interest in funding new affordable housing opportunities for some of America's most vulnerable populations – our elderly households and those with significant disabilities. As you know, $10 million was appropriated in FY 2017 for preservation and development of Section 202 senior housing, with another $105 million appropriated in FY 2018 for development of Section 202 housing, and $82.6 million appropriated in FY 2018 for development of Section 811 housing. We are currently working on implementing a strategy to direct this funding to where it will be the most impactful, including exploring ways to maximize the number of new units created and preserving as many properties as possible by first using existing programs.

Performance-Based Contract Administration

Project-Based Rental Assistance is administered by Performance-Based Contract Administrators (PBCAs). PBCAs conduct management reviews, facilitate Housing Assistance Payments (HAP), and adjust contract rents, among other duties. We appreciate the language this Subcommittee has provided to ensure that HUD solicits and awards PBCA contracts utilizing full and open competition in accordance with the Competition in Contracting Act and the Federal Acquisition Regulation. I would like to assure you this is our objective.

On March 13, 2018, HUD cancelled the two draft Housing Assistance Payments solicitations, which are commonly referred to as the "PBCA solicitations." Based on the extensive comments received in response to the draft solicitations, HUD is taking time to perform additional due diligence to ensure all comments and recommendations are considered in developing the final approach to obtaining the services to replace the current PBCA services. Future requirements will be initiated through a new solicitation, which is expected to take several more months to develop.

FHA Mortgage Insurance for Multifamily Housing and Healthcare Facilities

FHA's mortgage insurance programs for both Multifamily Housing and Healthcare Facilities fall under the General and Special Risk Insurance (GI/SRI) Fund. Like the MMIF for Single Family, the FY 2019 Budget requests no subsidy budget authority for GI/SRI's mortgage insurance programs. The Budget estimates $629 million in offsetting negative credit receipts in 2019 from loan guarantees. We monitor the fund balance carefully for GI/SRI, too, and are mindful that taxpayers stand behind each and every dollar in commitment authority.

The GI/SRI mortgage insurance programs allow communities to not only provide quality affordable housing, but also access to assisted living/nursing home facilities and hospitals by supporting the cost of care and the needs of aging and vulnerable populations. FHA mortgage insurance facilitates fixed-rate loans and refinances with long-term amortization, to a greater extent than conventional lending sources. These are designed to reduce borrower costs and boost housing and healthcare opportunities for communities across the country.

Office of Manufactured Housing Programs

HUD also plays an important role in manufactured housing, which is a critical component of affordable housing in the United States. Manufactured housing provides nearly 10 percent of the nation's Single Family housing stock. An estimated 22 million American households reside in manufactured housing.

HUD, through its Office of Manufactured Housing Programs (MHS), administers the National Manufactured Housing Construction and Safety Standards Act of 1974. MHS is responsible for establishing so-called HUD Code, which are federal standards for the design and construction of manufactured homes to assure quality, durability, safety, and affordability. Currently, 35 states participate in the program under HUD-approved state compliance plans and are reimbursed by HUD for their activities as required by federal regulation. HUD administers a compliance program for the remaining 15 states.

HUD coordinates with the Manufactured Housing Consensus Committee (MHCC) to recommend revisions to, and interpretations of, the manufactured housing standards and regulations. HUD also develops and implements model standards for installation of manufactured housing, as well as an installation enforcement program. HUD administers installation enforcement programs in 14 states and oversees HUD-approved programs in 36 states. Finally, HUD administers a statutorily required dispute resolution program for manufactured housing homeowners, retailers, installers, and manufacturers in 25 states and approves state dispute resolution programs in 25 states.

Fees are charged to the manufacturers for each transportable section produced to offset the expenses incurred by HUD in carrying out its responsibilities. The FY 2019 Budget proposes to fund the $12 million cost of authorized activities through these fees.

In accordance with the President's Executive Orders on reducing regulatory burdens, in January 2018, HUD announced a top-to-bottom review of its manufactured housing policies. We 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. The comment period closed on February 26, 2018, and we are currently reviewing the comments. We also plan to work with the MHCC to develop policies that ensure manufactured housing remains an accessible and affordable source of housing for millions of American families.

Office of Housing Counseling

HUD acknowledges the importance of access to independent, unbiased information for potential homeowners and renters who are considering making the big decision to buy or rent. HUD supports and provides oversight for a national network of nonprofit and government housing counseling agencies. Their goal is to work with current and prospective homeowners and renters to help them make responsible housing choices.

The Housing Counseling Assistance Program provides: 1) comprehensive housing counseling services to homebuyers, homeowners, and tenants through grants and counselor training; and 2) training and guidance to housing counselors and staff of government or non-profit entities that participate in HUD's Housing Counseling Program. Housing counseling services include group education and individualized housing counseling on pre-and post-purchase homeownership, budgeting and financial management, reverse mortgage counseling, homelessness prevention, rental counseling, and avoiding discrimination, foreclosure, and eviction.

The objectives of the housing counseling program include overcoming barriers to stable and affordable housing, expanding sustainable homeownership and rental opportunities, preventing foreclosure and eviction, and deterring discrimination, scams, and fraud. The FY 2019 Budget requests $45 million for this program, the bulk of which funds grants to HUD-approved housing counseling agencies for direct services. To strengthen housing counselor training, HUD plans to continue implementing individual testing and certification for housing counselors. HUD is also analyzing how counseling grants could be directed to better serve those affected by disasters, and to reduce HECM tax and insurance defaults.

Conclusion

In conclusion, thank you again for the opportunity to detail some of the important work HUD is doing through its Office of Housing. FHA has allowed millions of American families to benefit from homeownership and affordable rental options, while providing vital countercyclical liquidity in the nation's mortgage finance markets.

This Administration recognizes that our ability to fulfill our primary mission of providing sustainable homeownership opportunities can only be accomplished if we are good stewards on behalf of the taxpayers who support FHA's insurance programs. We are committed to that goal and look forward to working with Members of this Subcommittee to accomplish this.