

Comments by  
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How many of you have seen the commercial for Microsoft's new windows software – the “wow” commercial?

It's my favorite commercial because it takes you through a series of uplifting and nostalgic moments when all you can say is “wow” and it leaves you with a good feeling about life and not coincidentally, about Microsoft's Vista.

Well, as I was first reading the President's proposed FY 2008 budget, all I could say was “Wow” – and this wasn't a feel-good, uplifting “Wow” – this was a depressing feeling.

Just a few examples from a housing finance perspective:

- The baseline credit subsidy rate for FHA's single family program is positive which means the MMI is losing money and will require an appropriation of credit subsidy or increased premiums – Wow
- Again this year, despite strong industry and Congressional opposition, the budget proposes an increase in the MIP for the multifamily new construction/sub rehab and refinance programs – Wow
- Again Ginnie Mae is targeted with a new upfront premium and with a removal of Ginnie Mae's authority to spend funds from their reserves to cover contracting and other costs – Wow

And if this isn't depressing enough, the budget proposes a cut in funding for updating the flood maps – in the face of outdated and difficult to read maps that left many families in the path of the 2005 hurricanes uninsured because they didn't know they were in a flood plain - Wow

To be fair, there were some positive “Wows” in the budget proposal. There is recognition that FHA needs to be modernized with proposals for increasing mortgage limits on both the SF and MF sides mentioned. And the GSE discussion, was, at least from the finance industry's point of view, quite positive as it addresses areas where new regulatory powers are needed while not providing specifics that could unnecessarily limit negotiations among the parties.

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Let me go through each of these issues in a little more detail.

First, the Ginnie Mae changes. These were proposed last year and both the new fee and the change requiring appropriations for all Ginnie Mae expenditures require Congressional action. The new fee is, on its face, absurd. According to the budget, in FY 2008 Ginnie Mae's MBS program will generate almost \$400 million in income. With the estimated \$46 million in total expenditures, that gives you over \$350 million of net income. It is difficult to understand why a new fee is needed except to generate funds for other programs – to me that's simply a new tax on families that receive FHA and VA loans.

On the issue of requiring appropriations for all of Ginnie Mae's expenses, that is moving backwards. We should be moving FHA to have more Ginnie Mae-like flexibility. Each agency should have the authority to use some of their reserves to contract for assistance – whether that be Ginnie Mae's contract to make monthly payments to security holders under the Ginnie Mae II program or FHA's need to fund improved technology in a myriad of areas – more on that later.

Congress rejected both Ginnie Mae proposals last year and we expect them to do the same this year. But it was very disappointing to see these proposals again and to have to spend time and energy fighting them again.

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On the increase in the MIP for certain multifamily programs, OMB was a little more strategic this year. They exempted nursing homes and hospitals, as they should because it makes no sense to increase rents on properties that Medicare and Medicaid are so heavily subsidizing. And they were strategic in reducing their increase by half. They are proposing only a 16 basis point increase – from 45 to 61 basis points – instead of the 32 they tried last year.

The Administration says they are doing this to cover administrative costs; however, nowhere in the Credit Reform Act of 1990 is there any requirement that administrative costs be covered in the calculation of credit subsidy. The programs that the Admin is attacking – Section 221(d)(4) and 223(f) both generate income for the government and the 223(f) program generates substantial income (\$47 million in negative credit subsidy in FY 2006 – using the Administration's own numbers).

This substantial increase in the MIP will cause rents to go up by approximately 21/2% or will cause the mortgage amount to be lowered by about 21/2%. That translates into less rehabilitation that can be done on a property (approximately \$250,000 on a \$10 million mortgage) or could make some properties infeasible. We understand that, like last year, the Administration proposes to exempt properties with low income housing tax credit equity from the fee increase. This seems to indicate that they believe projects without tax credits do not serve low and moderate income families. We beg to differ.

The HomeBuilders produced some great statistics last year using 2001 Residential Financial Survey data that demonstrates that a majority of FHA-insured, unsubsidized, rental housing is affordable to households with incomes at or below 60% of area media income. Looking at the chart provided you can see that in CA, for example, where there are over 2,000 FHA-insured properties that have no subsidy at all, 10% of the units are affordable at 30% of median income, 81% are affordable at 50% of median and 91% are affordable at 80% of median. Clearly FHA is serving low and moderate income families even when there is no subsidy involved.

Congress rejected the MIP increase last year, but this year may be tough because both the number of programs affected and the increase have been reduced. However, the principle remains the same: affordable housing programs should not be taxed to provide funding for other programs.

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Moving to the FHA single family program, there is clearly a crisis in the program and HUD has picked up on that in their recommendations for a risk based premium, more flexibility in designing new programs and an increase in the loan limits. In any insurance fund you need to spread your risk and FHA is currently being adversely selected.

Just to give you a few numbers:

In 1990 13% of new SF originations were FHA-insured.

In 2006 only 3% were FHA-insured. This is a pretty dramatic decline.

Why do we need FHA? Here are a few more numbers: almost 80% of FHA-insured loans go to first time homebuyers.

FHA is particularly important to minority and low-income families. HMDA data shows that in 2004:

- 14.2% of FHA borrowers were African American compared to only 5.4% of the conventional market.
- Hispanic borrowers made up 15.3% of FHA loans, while they were only 8.9% of the conventional market.
- Over 57.9% of FHA borrowers earned less than \$50,000, doubling the conventional market's percentage of 27.6%.

FHA's decline has a number of causes. The largest single cause, however, is the lack of flexibility in the programs. FHA has:

- no authority to change the cumbersome downpayment calculation;
- no authority to adjust premiums to better reflect risk; and
- no authority to introduce new programs or variations on existing programs.

FHA's internal processes are also daunting and have driven many users away from the program. Let me interject one positive note here: Commissioner

Montgomery has been steadily chipping away at many of those obstacles and we are working with HUD to streamline operations within their control.

Many of you in this room remember the Millennial Housing Commission's Report – issued in May 2002. In that report, they suggest a number of changes to FHA's structure and operations to make it a more viable agency. MBA, with several other industry groups, has been advocating similar changes and hopes to make some progress this year. While we have not pursued structural changes – like making FHA a wholly owned corporation within HUD – we have advocated for many of the changes that would provide FHA with more flexibility.

We would like to see Congress give FHA more authority

- to innovate with new products and programs,
- to hire and adequately compensate experienced staff and
- to have more control over its reserves – similar to what Ginnie Mae has now– so that it can bring its technology into the 21<sup>st</sup> Century.

As an aside, I was in a meeting last week with HUD's Real Estate Assessment Center staff. Their system for property inspections continues to be based on Windows 95 software because they don't have sufficient development funds to implement an updated system. REAC's system is used for tens of thousands of property inspections on everything from public housing to FHA-insured properties. It is unbelievable that in the past five years they have not been able to make many needed changes to their inspection protocol because the current software simply can't sustain more changes and there is no funding to install a new system.

Put very simply, FHA's market influence and share of the market continues to decline and FHA is increasingly becoming the lender of last resort. Without significant changes in both the administrative and legislative restraints on the programs, their viability will soon be called into question. Not only will the programs' positive impact on HUD's budget continue to decline, but it is only a matter of time until they become irrelevant because the mortgage insurance premiums needed to sustain them will be too high for families to afford.

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The budget document does not provide much detail on the Administration's position on legislation to improve the oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. While stating forcefully areas where the regulator needs expanded powers, the Administration does not specify legislative constraints on items such as the GSEs' portfolio holdings. This approach leaves room for negotiations which could produce a bill this year that is acceptable to all parties. While there was great optimism at the end of last year and earlier this year, it appears that agreement on the details is more troublesome than originally thought. I'm not going to guess the outcome of the negotiations, but I do want to touch on a few aspects of the debate.

First, the affordable housing fund that Fannie and Freddie would be required to capitalize. There are numerous approaches to how the amount to be contributed by the GSEs would be calculated. They range from a % of profits to a percentage of their outstanding portfolios to a percentage of the loans or MBS they purchase. The dollar amount generated varies widely but I've heard anywhere from \$300 million to \$800 million annually.

MBA is not lobbying for or against such a fund, but if Congress does create a fund, we would like to see the percentage applied to the amount of their outstanding portfolios because it would make it more difficult to pass on this cost to homebuyers and renters. We also would like to see one fund that is not controlled by the GSEs, where the funds are distributed by formula – preferably a formula like that for HOME funds which would distribute the funds to cities as well as states for their use in assisting very low income families.

MBA would also like to see some changes to the affordable housing goals in any GSE legislation. We would like to see more targeting of the goals with more emphasis on families below 80% of median income. And we would like some adjustment to what counts toward the goals. For example, we believe that purchases of investment grade tranches of mortgage backed securities or REMICs should not count toward the goals. And we believe that if a lender has to buy back loans from a GSE, the GSE should not be allowed to count those buy backs toward their goals.

In conclusion, there are a lot of “Wow” moments in this budget proposal for affordable housing finance. But most of them are not ones that Microsoft would want to highlight in a commercial.