COMMUNITY
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October 8, 2019

The Honorable Brian D. Montgomery
FHA Commissioner and Assistant Secretary for Housing
U.S. Department of Housing & Urban Development
451 7th Street, SW
Washington, DC 20410

Re: HUD Housing Finance Reform Plan

Dear Commissioner Montgomery:

We are writing to share our views about the Department of Housing and Urban Development's (HUD) Housing Finance Reform Plan (Plan) with respect to the Plan's significant reduction in the Federal Housing Administration (FHA) role in mortgage credit and homeownership.

The Community Home Lenders Association (CHLA) is composed exclusively of small and mid-sized non-bank mortgage lender/servicers, known as independent mortgage bankers (IMBs). IMBs, which currently originate over 80% of FHA-insured loans, have played a critical role in ensuring home purchase and refinancing mortgages for low- and moderate-income income homeowners, including minority and rural households, many in underserved communities.

CHLA has been publicly supportive of a number of FHA managerial improvements included in the Plan, including more flexible pay scales for FHA and Ginnie Mae employees, modernization of its outdated information technology (IT) systems, and better alignment of penalties for missed servicing deadlines with the severity and financial impact of such penalties.

CHLA is sympathetic to FHA concerns about the financial impact of Down Payment Assistance Programs (DPA) and PACE loans, and would support appropriate changes to reduce risk in those areas, as well as other loan types where there is demonstrable evidence of excessive risk.

However, any actions to reduce FHA loan availability should not be based on an arbitrary objective of reducing the government footprint – but should instead be based only on clear evidence of excessive risk for certain loans. Consistent with FHA's charter, FHA should also consider the impact of any changes to FHA's statutory access to mortgage credit duties.

Therefore, CHLA is opposed to proposals in the Plan to limit FHA loans to borrowers not served by traditional underwriting, to eliminate FHA loans for repeat borrowers and for conventional to FHA refinances, and to reduce availability of cash-out refis.

CHLA also opposes risk-based pricing (referred to in the Plan as "tiered" pricing) and opposes any Congressional action to increase the MMIF net worth requirement, using risk-based capital.

REDUCING FHA'S FOOTPRINT

The Plan explicitly advocates that we should "Refocus FHA to its Core Mission" by "Targeting Programs to Borrowers not Served by Traditional Underwriting." As noted, this includes elimination or reduction of a number of different types of loans, including repeat borrowers or different types of refinance products.

It is true that FHA's role has traditionally been to help borrowers not well served by other mortgage sources. However, this process has generally worked by self-selection; FHA loans are generally more costly than conventional or bank loans, and therefore borrowers who can obtain a conventional or bank loan do so, while those who cannot generally gravitate to FHA. A variation on this conclusion is that FHA generally offers lower down payment requirements than other mortgage options and therefore some borrowers who could obtain other types of loans use FHA for this reason.

Therefore, it does not make sense to arbitrarily roll back the role of FHA in mortgage credit, due to either the goal of reducing FHA's footprint or shifting loans from FHA to Fannie and Freddie or to banks or other so-called "private capital."

In fact, this kind of "Field of Dreams" approach ["Build it and they will come" – or in the mortgage context, get FHA out of the way so "private capital" can step in to replace it] is most likely to result not so much in a shift of market segments – but in a significant number of low- and moderate income homebuyers and homeowners being denied access to mortgage loans. This is particularly true since there does not seem to be any analysis to support the conclusion that other lenders – particularly private capital - will serve borrowers who would be abandoned by FHA under the Plan.

The second major problem with trying to reduce FHA's role to its lowest income and lowest credit quality borrowers is that it will exacerbate "adverse selection." If only the riskiest borrowers can obtain FHA loans, the result will be an increase in default rates, foreclosures, and loans losses, which would inevitably jeopardize the health of the FHA Fund.

FHA has maintained a strong financial track record for 80 years because it has a mix of borrowers, by income and credit quality. This approach should not be jettisoned.

TIERED PRICING

Equally troubling is the Plan's proposal to use a variation on risk-based pricing, which the Plan calls "tiered pricing." Risk-based pricing entails varying fees based on the risk of the borrower. This approach was fully debated by Congress and rejected in the 2007 FHA legislation, which included comprehensive changes to the FHA program that were later enacted into law in the 2008 HERA legislation.

Risk-based pricing was rejected because it undermines the long-standing principle of cross-subsidization that has worked well for FHA for decades. Higher credit quality borrowers pay the same fees as lower quality borrowers – which stabilizes the finances of the program by providing the profits to enable FHA to affordably serve borrowers more in need.

The Plan proposes what it calls “Tiered pricing” – which appears to include charging lower credit quality FHA borrowers more – but does not appear to reduce pricing for higher quality borrowers (presumably because that would result in more FHA borrowers in that segment, which the Plan wants to discourage and private mortgage insurers oppose).

However, the principle and the impact would be the same as risk-based pricing -– eliminating homeownership and refinancing opportunities for underserved borrowers, or at a minimum raisings costs and mortgage rates for such borrowers.

INCREASE IN FHA NET WORTH REQUIREMENT

Finally, the Plan proposes increasing FHA’s MMIF 2% Net Worth requirement and using a risk-based capital scheme.

Revising FHA’s net worth requirement to increase capital related to riskier loans or riskier borrowers would inevitably exacerbate the impact of the Plan, by creating even more incentives for FHA to raise prices on underserved and minority borrowers.

Moreover, raising the 2% net worth requirement is not necessary and could be counterproductive. The 2% net worth requirement worked well in terms of FHA surviving the worst recession since the great depression in 2008. FHA stepped in to perform its countercyclical role right after the crisis – ensuring mortgage loans in a market where prices were falling, thus exacerbating FHA losses. Nevertheless, only a very small advance from Treasury was needed for the FHA fund. Since then, the FHA Fund has rebuilt itself – surpassing the 2% ratio, and almost reaching a 4% net worth ratio when HECM loans are excluded.

Therefore, Congress should reject proposals to raise FHA’s net worth ratio as well as proposals to use risk-based capital in such net worth requirement.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION