ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

DEC 18 2012

U.S. Senator Bob Corker
185 Dirksen Senate Office Building
Washington, D.C., 20510

Dear Senator Corker:

Thank you for your commitment to the health and stability of the Federal Housing Administration (FHA), as expressed most recently at the December 6, 2012 Senate Banking Committee and through your proposed amendment designed to strengthen and protect FHA's Mutual Mortgage Insurance Fund. Secretary Donovan and I share your concerns and I am committed to continuing to take aggressive action to rebuild the reserves of the Mutual Mortgage Insurance Fund, which have been so negatively impacted by the legacy loans insured by FHA – particularly those from the 2007-2009 vintages.

As you know, the actions we have taken to date, including those recently announced in our Annual Report to Congress, are designed to increase recoveries from this legacy book, price risk appropriately on new loans, and begin to shrink FHA's presence in the market. You and I agree, however, that more can and should be done to correct fundamental structural problems in FHA's reverse mortgage program (the Home Equity Conversion Mortgage, or HECM, program), and to refine FHA's risk profile so that both FHA and borrowers are better able to weather the difficulties of any future downturn in the housing market and economy. We are also committed to measures that facilitate the return of private capital to the market. I appreciate your strong advocacy to ensure that FHA takes the actions needed to restore its financial health. I would like to address each of the four critical policies you raised and the immediate actions FHA is taking to address them:

1. <u>Minimum Credit Score for New FHA Loans</u>: FHA is finalizing a formal policy directive (Mortgagee Letter) that will require borrowers with credit scores below 620 to have a maximum total debt-to-income (DTI) ratio no greater than 43 percent in order for their loan applications to be approved through FHA's TOTAL Scorecard, a system used by lenders to score the quality of an FHA loan application. If a borrower's DTI exceeds 43 percent, lenders will be required to manually underwrite the loan, and to document compensating factors that qualify the borrower for FHA-insured financing, such as a larger down payment or a higher level of reserves. Our preliminary data indicate that this requirement would reduce claim rates by approximately 20 percent for borrowers with credit scores of 620 or below. I believe this policy change will significantly strengthen the extent to which FHA is protected from unwarranted risk and borrowers are offered loans that are sustainable for them.

2. <u>Moratorium on the Full-draw HECM Reverse Mortgage:</u> Through the HECM program, seniors have access to a number of different product options. However, in recent years, several structural problems have developed that have altered the usage of FHA's HECM products, changing the risks associated with the program. While declining home prices and greater longevity of seniors have yielded greater projected losses, another major contributor has been the lack of a secondary market for these loans. There are many explanations for the evolution of these complexities, but the end result has been an increase in risk to both FHA and borrowers that must be rectified immediately. As discussed in our Annual Report to Congress, FHA is preparing a policy directive that would result in the immediate cessation of the use of the Standard Fixed Rate HECM product. This product currently represents a large majority of the loans insured through the HECM program, with the Variable Rate Standard product and the HECM Saver products (Fixed Rate and Variable) representing the balance. The amount that can be drawn under the Saver product is substantially less than under the Standard program, and the upfront fees to the borrower are all but eliminated for Saver loans. Eliminating the use of the Fixed Rate Standard program is an immediate stop gap measure, and FHA will also commence rulemaking to make several other important changes, including establishing formal guidelines for conducting financial assessments of borrowers and the creation of set-asides for payment of taxes and insurance.

3. <u>Scale Back of FHA Market Share:</u> In June 2012, FHA began administratively pricing mortgage insurance premiums for large loans (loans above $625,500) at a level 25 basis points higher than those with lower loan limits (150 bps compared to 125 bps). FHA, as mandated by Congress, is currently the only federal entity able to insure loans between $625,500 and $729,000. FHA is committed to taking steps to redirect this business to the private market where it has typically been served. With the premium increase we announced in November, these large loans will now be priced at the current statutory maximum for annual mortgage insurance premiums (155 bps). Further, FHA will implement a policy change that lowers the maximum loan-to-value ratio on loans above $625,500 to 95% from 96.5%, or in other words, raising the down payment from 3.5% to 5% for these loans. The combination of a higher down payment and higher mortgage insurance premiums for these loans will continue our efforts to drive this business to the private market.

4. <u>Access to FHA Loans After a Foreclosure:</u> Borrowers are able to access FHA-insured financing three years after they have experienced a foreclosure <u>*only if they have re-established good credit and qualify for an FHA loan in accordance with the fully documented underwriting requirements for any FHA-insured mortgage origination*</u>. FHA is concerned that a few lenders are inappropriately advertising and soliciting borrowers with the false pretense that they can somehow "automatically" qualify after three years. First and foremost, FHA will step up its enforcement for FHA-approved lenders with regard to such advertising and remind them of their duty to fully underwrite loan applications in accordance with FHA guidelines. In addition, the credit score/DTI policy outlined above will be applicable to borrowers seeking to obtain FHA-insured financing following a foreclosure. Furthermore, FHA is committed to performing additional data analysis to determine if the original cause of a borrower's

foreclosure was due to a one-time economic event, such as the loss of employment that has since been regained, and whether that results in any different or better performance than other reasons for foreclosure. This effort may inform future policies in this area. Finally, as discussed in our Annual Report to Congress, FHA is also committed to structuring a new housing counseling initiative that would apply to a number of borrower classifications, including borrowers with previous foreclosures.

Senator, I deeply appreciate the advocacy, focus, and concern you bring to ensuring that the Mutual Mortgage Insurance Fund is restored to financial health as rapidly as possible. I share your sense of urgency about these matters, and I commit to you that I will move on these additional actions by January 31, 2013, and I have confirmed that the Administration will support these new policies. You have my word on this and I expect to be held accountable to perform.

Sincerely,

Carol J. Galante

Carol J. Galante
Acting Assistant Secretary for Housing –
Federal Housing Commissioner