FHA MEANS BUSINESS—*and* Opportunity

At a time when most in the industry moved away from government lending (after noting Federal Housing Administration's [FHA's] diving market share along with other problems that plagued the organization), Charlotte, North Carolina–based Bank of America went the other way: We bolstered our commitment to grow our FHA business. ▲ While our previous experience with FHA validated the concerns of others, a series of events built our confidence that government loans could once again play a vital role in increasing homeownership opportunities. ● In June 2005, the leadership of Bank of America initiated a strategic plan to build out our FHA and Department of Veterans Affairs (VA) mortgage loan programs and fulfillment capabilities. Next came the July 2005 confirmation of Brian Montgomery as the new assistant secretary for housing /federal housing commissioner, and along with that came a spirited pace of FHA reform. ■ Later, in November 2005, Bank of America dispatched a team

None other than financial-services giant Bank of America is growing its government lending infrastructure. The megabank is bullish on the FHA mortgage program.

BY ALLEN H. JONES

BANK OF AMERICA

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of mortgage executives to the FHA Lenders Conference in Hollywood, Florida, and we immediately saw this was not a typical FHA conference. It was a special session worthy of FHA's rich history and prominent role in innovating and pioneering in the mortgage business.

It was here that Montgomery was introduced to our industry. And it was readily apparent to those in the audience that here was a man on a mission. It was clear he had a mindset for change of no small magnitude.

We realized, too, that to be successful in the FHA business, we had to appropriately invest in the infrastructure and experience of our team. To that end, in August 2006 we celebrated the grand opening of a National Government Fulfillment Center in Jacksonville, Florida—a center dedicated to one thing: the fulfillment and closing of government loans.

The culmination of these events and our planning means Bank of America's investment in government lending places the bank in a position to take advantage of a revitalized and reinvigorated FHA-insured housing program.

This article lays out the reasons behind Bank of America's strategic decision to invest more in government lending; the factors we considered in making the decision; the impact new leadership at FHA had on our decision; our view of the prospects for FHA reform; and how, in short order, we implemented this one element of our overall strategy to grow mortgage share and say "yes" more often to our customers.

The decline of FHA's share and the growth of subprime

Providing a stark contrast to our decision to embrace FHA were a lot of data suggesting lenders were looking in other directions to grow their business.

According to an August 2006 Mortgage Bankers Association (MBA) and Research Institute for Housing America (RIHA) study titled *Lender Perspectives on FHA's Declining Market Share,* between 2000 and 2004, FHA's share of single-family originations declined from 16 percent to 5 percent, while its share of total mortgage debt outstanding fell from 20 percent to 9 percent.

Some lenders viewed this as conclusive evidence of the demise of FHA, and exited the business altogether. Others retrenched or watched from the sidelines.

One of the authors of the MBA/RIHA report, Bernadette Kogler, managing principal of the Hollister Group LLC, Washington, D.C., says, "Despite the notion that much of the FHA product is now going toward the agency [government-sponsored enterprise (GSE)] market, the GSE share declined 9.8 percent over the past two years and the trend suggests that much of the surge in product has been in the form of alt-A and subprime."

And a review of the Feb. 24, 2006, *Inside Mortgage Finance* data show that, indeed, alternative-A market share increased to 12.5 percent in 2005, and the subprime market share increased to 20 percent in 2005.

While one could successfully argue that the glass is half-empty based on the market-share data alone, Bank of America counters that the glass is more than half-full based on our existing bank customer base and the demographics of the first-time homebuyer market.

The FHA borrower profile is a growth profile: nearly 80 percent first-time homebuyers, more than 30 percent minority and about 60 percent below median income. In an overall shrinking mortgage market, the first-time homebuyer can be a mortgage and a bank customer for life.

What's in vogue today can be passé tomorrow

History has demonstrated time and time again that financial markets can be fickle. Many industry observers point to FHA business as being countercyclical to the boom-and-bust cycles driven by refinance activity. From Bank of America's perspective, the growth opportunity FHA presents won out over its current disappointing market-share data.

FHA Commissioner Montgomery spoke loud and clear at the November FHA Lenders Conference, and shortly thereafter a series of program reforms were announced. At the same time, Department of Housing and Urban Development (HUD) Secretary Alphonso Jackson said, "I expect FHA Commissioner Montgomery to work with the industry and others to develop a strategy to get our share of the market back, rather than abrogating it to subprime lenders."

And many in the industry, along with Bank of America, took note.

"As our association looks at the demographics of first-time homebuyers through this decade and into the next, we view the recently announced changes at FHA as significant steps that will drive the homeownership rate of minorities higher," says Frances Martinez Myers, chairman of the National Association of Hispanic Real Estate Professionals (NAHREP), Washington, D.C.

Myers adds, "We are encouraged that HUD is leading the charge to fulfill the vision of the Blueprint for the American Dream [partnership, a collaborative effort of private and nonprofit organizations and the Bush administration to increase minority homeownership]. And we definitely see a revitalized FHA as one of the creative solutions for Latino homebuyers across this country."

What FHA has accomplished to date

Among the more significant changes that FHA Commissioner Montgomery has already put in place are changes to the FHA appraisal process and the closing-costs structure. In addition, it is important to note that as long as FHA borrowers qualify for insurance, they all receive the same interest rate.

HUD's goal is to streamline and simplify the FHA mortgage process for lenders and customers, bringing the requirements for government loans more in line with traditional mortgage loans. Specifically, FHA has made the following changes:

Mortgagee Letter 2005-48: Adoption of positive changes to the property inspection requirements for existing homes:

- Elimination of the valuation condition sheets and homebuyer summary, and adoption of the Fannie Mae appraisal forms;
- Requirement of termite inspection only when there are signs of active infestation;
- Acceptance of "as-is" appraisals, allowing minor property conditions that generally result from deferred maintenance and are not health and safety issues; and
- Requirement for well and septic inspections only in certain circumstances.

Mortgagee Letter 2005-43: Revision of the refinance guidelines, allowing cash-out up to 95 percent loan-to-value (LTV)

Mortgagee Letter 2006-04: Includes these positive changes regarding fees:

- HUD eliminated the "allowable" and "non-allowable" closing costs; and
- Lenders may charge reasonable and customary costs to close the mortgage.

Other attractive baseline FHA program features include the following:

- No minimum credit score;
- The borrower's cash investment may be a gift from a family member, employer or local government entity;
- The seller can pay up to 6 percent of the homebuyer's financing costs; and
- There are no prepayment penalties on FHA-insured mortgages.

From Bank of America's perspective, these operational changes have given new life to FHA. The bank is also encouraged by the improvement in HUD career staff morale and the "what-can-we-do-next" mentality they display.

The new logo FHA recently introduced, showing a house with an open door, is not just an empty marketing symbol—FHA is literally is opening the door to homeownership.

The need for FHA legislative reform

While we applaud the operational and regulatory reforms already achieved and see select FHA market opportunities in states such as Texas, Florida, North Carolina, Arkansas, Tennessee, Alabama, Indiana and Idaho, we agree with the broad political coalition that has banded together to support FHA reform legislation.

First-time homebuyers in California, New York and New England should be able to avail themselves of the safety and soundness that FHA offers. Today, with home prices pushing even the first-time buyer's red-brick rambler out of reach, FHA can only stand on the sidelines and watch as subprime lenders fill a significant part of the void.

Subprime lending fills a needed gap in providing loans to many who would otherwise be declined. However, the growth in subprime loans suggests that many consumers who can least afford it may be getting subprime mortgage loans when they would be better served with a more affordable FHA loan.

And a headline from the Aug. 30, 2006, *Wall Street Journal* tells a tale that former Federal Reserve Chairman Alan Greenspan and other public servants have been touting for more than a year: "Long and Short: Mortgage Market Begins to See Cracks as Subprime Loan Problems Emerge."

The FHA commissioner has not stood quietly by reading the headlines. Montgomery has taken his case for FHA modernization to Congress. He is asking for latitude to improve FHA's ability to reach further down the credit spectrum through risk-based pricing; by offering up to zero-down-payment loans to qualified borrowers; by raising mortgage limits in high-cost areas; by revising the condominium statutory guidelines to open up FHA to the condominium market again; and by testing new products with longer amortization schedules—and all the while doing so without costing the taxpayer a dime.

According to the *FHA Fiscal Year 2005 Actuarial Review,* FHA estimates it has an economic value of about $20 billion.

Other than its initial funding in 1934, which was repaid by 1940, FHA has been self-funded while serving more than 33 million homebuyers, and been the first rung on the homeownership ladder for low- and moderate-income borrowers.

The House of Representatives acts swiftly and decisively

The U.S. House of Representatives listened to the case being made by the FHA commissioner. Two House members from opposite sides of the aisle—Reps. Bob Ney (R-Ohio) and Maxine Waters (D-California)—ended up introducing The Expanding American Homeownership Act of 2006 (H.R. 5121). The proposed legislation included all of the FHA commissioner's requests and provided special dispensation for lower-income borrowers, including the creation of mortgage insurance premium caps and automatically lowering the premiums in the later years of the loan. The House voted 415-7 and passed H.R. 5121 in such a bipartisan fashion that many industry observers were caught by surprise.

But the coalition of bankers, brokers, Realtors®, home builders and consumer groups could not translate the nearly unanimous House vote into momentum in the Senate. As this goes to press, the Senate Banking Committee has not yet scheduled a vote on S.B. 3535, the companion bill on the Senate side, and the fall congressional season is shorter as we near the midterm elections.

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Bank of America, along with others in the mortgage industry, supports the proposed FHA legislation. First-time homebuyers should have choices in high-cost markets and should have a level playing field on down-payment requirements. The proposed legislation would provide those choices.

While passage of the legislation this year would benefit the homeownership opportunities of many first-time and minority borrowers, the debate about FHA has been long overdue and the prospects for ultimate reform have dramatically improved.

FHA outreach and marketing plans

And as the legislative debate continues, for the first time in years, FHA has invested in paid advertisements. In fact, FHA has procured $5 million in print advertisements.

According to a news release posted on HUD's Web site on Aug. 16, 2006, "FHA is expanding outreach to first-time and minority homebuyers by launching a newspaper-based ad campaign in 27 markets nationwide. The objective of the outreach campaign is to increase awareness of the quality and affordability of FHA products and services to low- and moderate-income, first-time and minority homebuyers. The campaign also focuses on the dangers of predatory lending and the protective nature of FHA products."

Bank of America's National Government Fulfillment Center

Bank of America agrees that FHA can help. And we are confident in the approach we have taken to implement our FHA strategy. We built out a stand-alone, dedicated national government fulfillment center to handle this aspect of our lending business. We are believers in FHA, but understand and appreciate that it is a government program.

To be effective and successful in this venture, Bank of America built appropriate infrastructure to enable fulfillment excellence and cycle turn times that will build Bank of America account executives' sales confidence. And it is a paperless environment that leverages FHA's lender insurance electronic endorsement process.

We have used the bank's Six Sigma approach, and recruited experts to lead this startup venture. One of the bank's first hires was Jane LeJeune, national government fulfillment executive—a 20-year veteran of government lending programs at a top government lender, who also has experience serving on MBA FHA committees and is a vocal leader.

The experience LeJeune brought to Bank of America was replicated through the hiring of 125 new associates for the National Government Fulfillment Center. Many of the new hires were attracted to Bank of America by the brand and the impressive statistics of the world's most profitable financial services company.

But many others were attracted to a chance to return to government lending—a place where many of us got our start in the first-mortgage business. The fact that "knowledge and service matter" became our mantra, and as we built out our team, the experience part was crucial.

The value of training

More than 1,300 individuals attended our hiring fair when we started recruiting our government lending staff. More than half had government lending experience. With two hiring waves, we were able to focus on training and refreshing skill sets to align with the new FHA.

We created a three-week curriculum that included both instructor-led and Web-based training. Tests were required. We had guest speakers from HUD's Atlanta Homeownership Center and from Potomac Partners LLC, a Washington, D.C.–based consulting firm. Moving the new associates out onto the floor and beginning the process of fulfilling government loans had its fits and starts, but the training and teambuilding environment fostered a smooth transition.

Ongoing fulfillment training is conducted by a trainer solely dedicated to FHA/VA training. It helps that our national onsite trainer, Teresa Campbell, is an FHA Direct Endorsement underwriter and former leader of a local housing agency.

The National Government Fulfillment Center team today is fully staffed with approximately 125 associates, and operational with functions including underwriting and fulfillment. With a laser-like focus on government lending, we successfully launched this new center on time and on plan.

Bank of America sees sales training as part of the infrastructure for success. So, we condensed our three-week fulfillment-training course into a shorter version for our sales force and segregated our account executives by tiers based on experience. Knowledge and service matter on the sales side, as well.

As the market slows and Realtors look to prospective FHA deals, it is a whole new world. FHA contracts are viewed by Bank of America the same way it views its other suite of mortgage products: Having more arrows in the quiver is better than having fewer. And when one of the arrows can turn a renter into a homebuyer, we have all succeeded.

David Lereah, chief economist for the National Association of Realtors (NAR), Chicago, shared his perspective with me: "Recent FHA changes are good news for the housing market, because a viable FHA provides greater and safer choices for the first-time homebuyer."

Lereah added, "Our [NAR's] members have been very encouraged with the steps FHA has taken to date, and now view FHA as a realistic option for low- to moderate-income homebuyers in many markets nationwide."

Bank of America account executives have embraced the training. More than 700 account executives have taken the FHA and VA courses in the first three months they have been offered. With fulfillment service levels in place and a knowledgeable sales force, Bank of America has a market opportunity that is as positive for the bank as it is for the consumer who can reach out and grab the American dream through a government-insured mortgage loan.

While some may view the infrastructure cost as daunting, it is the price of admission for successfully executing government loan programs. And from a risk perspective, knowledge and service protect Bank of America from the vigilance of a HUD audit and the significant fines large lenders have paid just this year for direct endorsement authority, Real Estate Settlement Procedures Act (RESPA) and Fair Housing Act violations.

Expectations of a partnership

On the flip side of the infrastructure investment, we would encourage HUD and the FHA team to consider the cost of admission and the performance of a lender in establishing business terms. We understand and agree that all lenders should be treated alike. However, we think those demonstrating through HUD's Neighborhood Watch system a loan performance level well below the national claim and default average, and having the financial wherewithal to absorb the risk a lender is willing to take, should provide a differentiated value to FHA.

If a lender invests in the infrastructure required to participate meaningfully in the FHA programs, and provides X dollars of premium income and positive credit subsidy, that should be a consideration for FHA in its treatment of that lender.

As Bank of America continues to invest in FHA and the needs of our first-time homebuyer base, we will continue to advocate for legislative change and further program reforms to simplify and streamline FHA. And while we do not expect FHA to grow market share back to the double-digit levels, we do expect growth in our share and a quality partnership that is beneficial to all.

The changes we have seen in the last year underscore that FHA is serious about the business, and that translates to opportunity for lenders. The signs point to the re-emergence and revitalization of government lending, and that's good news for lenders and homeowners alike. We encourage others to take a fresh, invigorated look at government lending for the benefit of homebuyers and their business. MB

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