CQ WEEKLY – IN FOCUS
Aug. 3, 2009 – Page 1834

FHA Steps Up in Crisis, But Can Pace Be Sustained?

By Karoun Demirjian, CQ Staff

The housing market may be showing signs of recovery, but home lending is still on government life support. With many homeowners rushing to refinance and private banks strapped for cash, federally backed agencies remain the biggest players in the mortgage market — and the most bulked-up federal lender is the Federal Housing Administration.

For much of its career, the FHA — founded in 1934 to tamp down the Great Depression's epidemic of home foreclosures — has been confined to the lower end of the mortgage market, where it proffered higher-risk loans to low-income borrowers.

But while government-backed lending giants Fannie Mae and Freddie Mac have been casualties of the present crisis, the FHA has had a resurgence. In fiscal 2006, the agency controlled just 4 percent of the market; by March 2009, that figure rose to almost 18 percent of all loans in the first half of fiscal 2009, including almost a quarter of new loan applications. And with the FHA's bulging new portfolio, Congress is rushing to ensure that the lender doesn't get overwhelmed and end up backing a battery of more bad loans. Most of all, lawmakers don't want to bail out yet another federal mortgage lender, as they prepare to face a recession-weary electorate in 2010.

FLACKING FOR FHA: Donovan at the Senate Banking Committee in June. (CQ / SCOTT J. FERRELL)

To forestall that scenario, Congress has recently loosened the FHA's lending strictures. Last week, lawmakers agreed to increase the FHA's commitment authority — the total amount of new loans the agency is allowed to insure in a given fiscal year — to ensure that it can continue to meet the robust demand for new mortgages and refinancing deals for the remainder of fiscal 2009, and thereby prevent a freeze in the market for housing credit.

Still, some lawmakers are questioning whether FHA can handle the vastly expanded new responsibilities it's taken on — pointing to the agency's plunging capital reserves as a cause for concern. As originally conceived, the agency is supposed to be self-sustaining, using revenue from insurance fees to supply the capital to guarantee new loans.

Those fees are not astronomical. Holders of FHA-insured loans make a 3.5 percent down payment (compared with an average requirement of 20 percent down for private sector, non-subprime loans). Upfront premiums are about 1.75 percent of the loan, and additional annual premiums are added until the loan-to-value ratio has shrunk to 78 percent, provided that the mortgage holder has paid the annual premium for at least five years.

But as more people take advantage of the FHA's lending terms, some fear the agency's capital reserves aren't keeping pace with demand. Sen. Christopher S. Bond, a Missouri Republican and the ranking member on the Senate Appropriations subcommittee that determines the budget for the Department of Housing and Urban Development and the FHA, calls the agency's potential exposure a "ticking time bomb."

"They went from 2 percent of the market to 24 percent, and they couldn't handle 2 percent. They didn't have the personnel; they didn't have the skills; they didn't have the IT to keep track of what they got," Bond added. "I don't see it getting better."

In fiscal 2007, FHA's Mutual Mortgage Insurance Fund — the main program administering the agency's single-family mortgage insurance — put up 6.4 percent in capital for the $332 billion in loans it insured. So far this year, that ratio has plunged by two-thirds and is now dangerously close to the program's mandated 2 percent floor.

In addition to expanding the FHA's commitment authority, Congress has sought to put new efficiencies in place in the administration of FHA loans — putting $20 million toward IT and fraud detection in the fiscal 2010 budget, for example. But if the housing market takes any sudden new plunges, the agency's reserves could go further south. That would leave Congress with a Hobson's choice: reduce or limit the agency's commitment authority — thereby causing a likely freeze in lending — or legislate a new floor the credit subsidies loan holders can access.

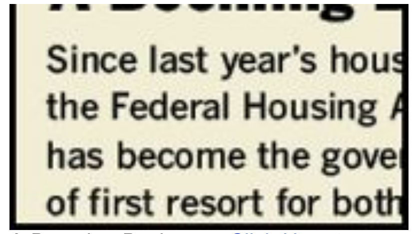
Even though some agency officials raised the specter of a taxpayer bailout earlier this spring, Housing and Urban Development Secretary Shaun Donovan insists there's no real cause for alarm. "We think there's a better than even chance that we will stay above the 2 percent reserve threshold," Donovan told senators in June, and projected that FHA would bring in more than $1 billion in fiscal 2010, keeping it well in the black. "That suggests, not just for the 2010 business, but overall for the portfolio, that we're more than likely to stay out of a broader need for any taxpayer funding," he added.

Quality Control

Industry observers say that it's at least as critical to monitor the quality of loans that the FHA is issuing now as it is to track the explosion in the agency's loan volume. It was, after all, the preponderance of overleveraged mortgages that pushed Fannie and Freddie to the brink last year.

That's why the FHA has not lowered its standards of creditworthiness. Indeed, FHA administrators have noted that the average FICO scores — a standard measure of creditworthiness in the lending industry — have increased by more than 50 points over the last year. And in turn, short-term delinquencies on FHA loans — failure to make single- family-home payments for 30 to 60 days — have dropped off, although payment failures for 90 days or more are increasing after a slight decline in the early spring.

Still, sound lending depends on more than just qualified borrowers. Market conditions have plunged, and home values have fallen to the point that almost a quarter of existing home loans are now



A Booming Business : [Click Here to View Chart]

"underwater," meaning the owners owe more than the houses are worth. FHA's loan portfolio includes many such loans, prompting Obama administration officials to announce a new round of FHA refinancing options last week.

Critics of the FHA's looser money policies say that such measures will only eat away at the broader stability of the lending market — and indeed, that the recovery thus far has been in spite of, not because of, the agency's lending initiatives.

"To an extent, the fact that things have not been quite as bad as predicted is due to the failure of the refinancing effort," said David John, a fellow at the Institute for Economic Policy Studies at the conservative Heritage Foundation. "They are refinancing thousands instead of millions of these mortgages."

But lending professionals say the FHA is just doing what it's always done, albeit on an unprecedented scale. "It's always a riskier population they're going to serve out of the gate," said Steve O'Connor, senior vice president for government affairs with the Mortgage Bankers Association. "It's an insurance fund, so it's going to be taking on risk."

FHA officials say that one need look no further than the rest of the housing market to see how they've safeguarded the quality of the agency's loan portfolio. Only 2.76 percent of FHA loans had reached any stage of foreclosure, according to data from the Mortgage Bankers Association — below the national foreclosure average of 3.85 percent, and well below the subprime foreclosure rate of 14 percent over the same period.

FHA loans certainly aren't getting smaller. Under last year's mortgage relief law and this year's stimulus legislation, lawmakers nearly doubled the ceiling for FHA-eligible loans — up to $729,750 for a single-family home, depending on local real estate values, through the end of fiscal 2009. And while some of the bigger loans come with bigger risk, supporters of the agency point out that they could enhance the longer-term viability of the FHA by virtue of the agency's funding model. "Larger loans carry larger insurance payments, and to the extent that we're starting to see prices moderate, those homes are becoming less underwater," said Andrew Jakabovics, associate director for housing and economics with the liberal Center for American Progress. "Recent activity is more likely to bolster rather than erode the MMI Fund."

What's more, advocates say, an expanded FHA portfolio remains the least bad option in a chastened housing economy — especially when the alternative is foreclosure. "That's the biggest threat," Jakabovics said. "Even paying out a partial claim and modifying a mortgage ends up being at far less cost to the taxpayer."

HUD Secretary Donovan is making just that case as he lobbies Congress for additional expansions of FHA's authority to back loans for at-risk borrowers — while also pledging to step up the FHA's monitoring of the nearly 12,000 lenders that offer FHA-backed loans, in order to reduce lender fraud and abuse. Lawmakers are expected to approve $20 million in the fiscal 2010 budget for those purposes.

Bailout Buffers

Congress well understands the need to keep FHA loans pumping on all cylinders. “If you didn’t have FHA in the marketplace, that would be like taking 25 percent of the credit market out, and you’d see the good news in the housing market reversed,” said one Senate Democratic aide who works on FHA oversight but is not authorized to speak to the media on the record. “So you really have to have this.”

But if the past year has taught Washington anything, it’s that talk of an entity being too big to fail can set the stage for a massive bailout — the worst-case scenario for the FHA. “Congress is not going to let it run out of funding,” said the Heritage Foundation’s John. “But most of the predictions I’ve seen for FHA growing out of its problem assume that the economy is going to recover quickly. And as much as I would dearly love to see that happen, I don’t necessarily think that’s the case now.”

Lawmakers, for the most part, aren’t in doomsaying mode. “It’s very hard to make judgments on how the market will be a few years from now,” said Barney Frank, the Massachusetts Democrat who chairs the House Financial Services Committee. Frank said he does, however, expect to see the FHA get more robust as it expands its commitment authority and more fees are paid in.

And lenders and market players are willing to back plans to continue expanding the FHA — not that they really have a choice. “Clearly the FHA’s critical to stabilizing the new loan housing market,” O’Connor said. “Right now, FHA’s one of the pillars in the housing finance system, and lenders want to have FHA as a reliable business partner.”

FOR FURTHER READING: *Stimulus law (PL 111-5), CQ Weekly, p. 352; Fannie Mae and Freddie Mac bailout (PL 110-289), 2008 CQ Weekly, pp. 3268, 3257; Housing stimulus efforts, p. 1834*.

Source: **CQ Weekly**
The definitive source for news about Congress.
© 2009 Congressional Quarterly Inc. All Rights Reserved.