

Four FHA Facts



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Background

With the upcoming House Financial Services Committee hearing on February 26, 2015 entitled “The Future of Housing in America: Oversight of the Federal Housing Administration,” we thought it would be a good time to take a look at what’s happening at the Federal Housing Administration (FHA).

FHA’s mission is to make owning a home an achievable goal for first-time homeowners and families with a working-class income. They do this by providing insurance to lenders who extend mortgage loans to Americans who might not otherwise be able to get a loan due to their income or credit score. However, the FHA doesn’t provide insurance for free: borrowers must pay premiums (both upfront and annual) to the FHA. Should property insured by FHA go into foreclosure, FHA takes the property over by purchasing it through a capital fund called the Mutual Mortgage Insurance Fund (MMI Fund). The MMI Fund is financed primarily from the premiums FHA collects from the borrowers it insures.

Over the years, FHA has generally been successful at keeping loans affordable for families who otherwise wouldn't have credit extended to them. But, because of FHA's mission, there is inherent (and accepted) risk associated with the loans because the borrowers they target are typically families with lower credit scores.

Fact 1: FHA's finances have improved.

The calamity of the financial crisis placed a heavy burden on FHA's balance sheets. But thankfully, the improving economy has led to a recent decline in default and foreclosure rates at the FHA—serious delinquencies (i.e. when a borrower hasn't paid their mortgage in over 90 days) at FHA are now around 6.9%, which is 1.1% less than a year before and 2.1% less from the recession high of 2011. With such positive news, the stage is set for an interesting debate on the House Financial Services Committee. Both the FHA and many policymakers are now refocusing on striking the right balance between financial stability at FHA and providing access to affordable mortgage credit to underserved borrowers.

Fact 2: However, FHA is in non-compliance with a mandate to keep capital at certain levels.

The MMI Fund's capital ratio is a snapshot of how much capital is on hand relative to total dollar volume of loans insured at the FHA. Today, capital is \$4.8B and total volume of FHA loans is \$1.2T meaning the capital ratio is 0.41%. The law requires the ratio to be at 2% or higher.

The ratio is based on annual actuarial estimates and, due to statutory requirements, the estimate assumes FHA will not insure any more mortgages going forward (i.e. close shop). With this in mind, FHA is not closing shop, so be cautious when looking at this ratio.

- Ever since FY2009, the capital ratio has been below its 2% target—marking the first time this has happened since the ratio was implemented and first met in 1995.

- The shortfall in capital is largely attributed to: 1) a batch of loans originated between FY2005 and FY2008 when lending standards were weaker at FHA, and 2) the financial crisis.¹
- Since 2008, the FHA has responded to capital deficiencies by tightening eligibility requirements and holding lenders more accountable.
- However, there is no statutory penalty for FHA missing the target, and some worry that more needs to be done to get the MMI Fund on firmer financial ground. This is especially true since the FHA announced in January 2015 a 0.5% decrease on annual premiums for FHA borrowers.
- While this decrease in premiums will encourage more borrowers to take out FHA loans, thus increasing the amount of premiums FHA collects, it also will cause FHA to take on more risk.
- The President's recent budget proposal highlights this premium decrease, saying it's a risk worth taking. The President argues that the increase in premium amount will far outweigh the risk associated with these new lenders to the tune of \$7B each year.²
- Projections from FHA's latest forecast argue that the capital ratio will be at 2% by FY2016.³

Fact 3: FHA may or may not have been bailed out.

FHA has permanent and indefinite authority to withdraw funds from the Treasury when its holdings are not sufficient to cover expected future losses on insured loans for that given year. So in FY2013 when FHA received \$1.7B in "bailout" funds from the Treasury, they were forecasting a loss.

However, according to testimony from former HUD Secretary Shaun Donovan, none of the "bailout" money from Treasury was ever used by FHA due to increases in mortgage insurance

premiums and settlements FHA received from mortgage company claims that year. ⁴

- The difference between budget authority and budget outlays is easily confused. FHA was given the budget authority (by statute) to spend the \$1.7B. However, they never needed the money, so it was never spent (budget outlays).
- Even still, concerns about a continual need for Treasury assistance are real and put taxpayers at risk for another “bailout.” However, the President’s FY2016 budget proposal, projects that FHA will not require another bailout in the upcoming fiscal year. ⁵

Fact 4: The profile of FHA loan recipients has changed.

In 2014, only 10% of FHA loans went to borrowers with credit scores of 640 or less. To put this in context, credit scores range from 300 (bad) to 850 (excellent). Today, Fannie Mae’s lower bound for borrowers it is willing to lend to is 620. And, the consensus in the private market is that you generally need a credit score of 680 or above to receive a mortgage with “good rates.” In FY2014, nearly 90% of FHA loans went to families with credit scores above 640 (approximately 45% of which go to families with scores in the 680–850 range). ⁶ Since 2009, the percentage of “<640” borrowers at FHA has been at or around this same level.

- This level of involvement by FHA in the housing market could mean one of two things. On the one hand, FHA could be encroaching on or “crowding out” the private sector’s ability to provide insurance and financing for borrowers.
- Alternatively, it might mean that lending standards in the private market are so tight that the only way these families can get loans is through FHA.

- 1.** United States, Office of Management and Budget, "The President's Budget for Fiscal Year 2016, Federal Credit Supplement Spreadsheets: Loan Guarantees: Subsidy Reestimates," Accessed February 6, 2015. Accessed at: <http://www.whitehouse.gov/omb/budget/supplemental>.
- 2.** United States, Office of Management and Budget, "Budget of the United States Government, Fiscal Year 2016," p.37, February 2, 2015, Accessed February 6, 2015. Accessed at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf>.
- 3.** United States, Department of Housing and Urban Development, "Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2014," p. 35, November 17, 2014, Accessed February 6, 2015. Available at: http://portal.hud.gov/hudportal/documents/huddoc?id=FY2014FHAAnnRep11_17_14.pdf.
- 4.** Written Testimony of Shaun Donovan, Secretary of U.S. Department of Housing and Urban Development, Hearing before the Subcommittee on Transportation, Housing and Urban Development, U.S. House of Representatives Committee on Appropriations on "FY2013 Budget Request for HUD," p. 7, March 21, 2012, Accessed February 6, 2015. Accessed at: <http://appropriations.house.gov/uploadedfiles/hhrg-112-ap20-wstate-sdonovan-20120321.pdf>.
- 5.** United States, Office of Management and Budget, "Budget of the United States Government, Fiscal Year 2016," p. 37, February 2, 2015, Accessed February 6, 2015. Accessed at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf>.
- 6.** Integrated Financial Engineering, Inc. "Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2014," p. 43, November 14, 2014, Accessed February 6, 2015. Accessed at: <http://portal.hud.gov/hudportal/documents/huddoc?id=AR2014MMIFwdRpt.pdf>.