MBA, NAR Outline Importance of FHA

By: Jann Swanson | Thu, Feb 28 2013, 2:33 PM

David H. Stevens, President & CEO of the Mortgage Bankers Association (MBA), and **Gary Thomas**, President of the National Association of Realtors® (NAR) testified today before the U.S. Senate Committee on Banking, Housing and Urban Affairs at a hearing titled, "**Addressing FHA's Financial Condition and Program Challenges**."

Stevens, who served as FHA Commissioner from 2009 to 2111 noted findings from FHA's 2012 Actuarial Review that the capital ratio of the MMI Fund had fallen to negative 1.44 percent which prompted concerns that it might need a draw from the U.S. Treasury and raised questions about whether FHA's policies need to be adjusted.

These findings Steven's said do not mean that FHA has insufficient cash to pay insurance claims, a current operating deficit, or will need to immediately draw funds from Treasury; only the President's FY2014 budget can make that determination. It is not surprising that FHA is experiencing significant losses on loans made during the recent crisis, as well as losses on the large volume of its new business.

The **soundness of FHA's financial position** is intricately tied to whether the assumptions and predictions behind the Actuarial Review hold true. While the industry is cautiously optimistic about FHA's recent programmatic changes, MBA recognizes the severity of the losses stemming from the 2007-2009 books of business are so great, and the uncertainty in forecasting economic trends is so high, that the possibility of a further decline in the capital ratio must be acknowledged as well as that other key variables such as the future paths of home prices and interest rates, can significantly sway the estimate of Fund value in either direction.

Stevens said FHA has already raised insurance premiums, increased and taken other steps to address many of the causes that have led to losses in its single-family portfolio. The credit profile and performance of the 2010 to 2012 portfolios demonstrate the effects of these changes.

MBA believes **further programmatic changes** at FHA must balance three priorities: restoring financial solvency; preserving FHA's critical housing mission; and maintaining the agency's countercyclical role. The Association plans to release a white paper next month that looks at various policy options to determine their impact on FHA.

- Limit excessive risk layering. Risk-based underwriting or specifying additional underwriting criteria or compensating factors within certain credit boundaries, could further reduce FHA's credit risk, but overly tight credit controls could mitigate against FHD's traditional borrowers. FHA must find the right balance. Locking in some of the overlays employed by lenders would protect FHA from any erosion in standards as market conditions evolve.
- Increase minimum downpayment requirement from 3.5 percent to 5 percent. FHA has already increased minimum downpayments for borrowers with a credit score below 580 to 10 percent and has proposed raising the minimum for borrowers with loans above $625,500 to five percent. FHA could continue this trend by designing a tiered downpayment structure based on credit scores where borrowers with the greatest risk of defaulting would be required to pay higher downpayments than borrowers with better credit scores.
- Establish a credit score floor of 620. FHA recently began requiring that borrowers with credit scores below that score have their loans manually underwritten to ensure adequate compensating factors. Establishing an absolute credit score floor would reflect the current market standard of private lenders, making FHA less subject to adverse selection. Borrowers with extremely weak credit may be better served by credit counseling and a slower path to homeownership, rather than an immediate and costlier loan.

A downside risk is that a minimum score of 620 could reduce affordable credit options for many borrowers especially penalizing some with a one-time credit damaging life event. Eliminating FHA as an option for credit-impaired borrowers might make the market fertile ground for a new subprime market and/or predatory lending.

- Requiring two month reserves and tightening DTI requirements for all borrowers would prepare homeowners to absorb major household expenses and would positively impact FHA's default rate. Moreover, this would be another way to verify if borrowers are truly financially prepared for the cost of homeownership. The changes however would also delay homebuying for borrowers who would potentially need to accumulate additional cash for a downpayment.
- The FHA high-cost loan limit of $729,750 is due to expire at the end of the year and will then match the current GSE limit of $625,500. Stevens said this will help return FHA's focus to serving low-to-moderate income and first-time borrowers. MBA data indicates that less than one percent of FHA-insured loans are between $625,500 and $729,750 anyway and it appears that as demand for larger loans grows, the need will be adequately served by the private sector.

On the **other hand**, larger loans tend to perform better compared with similar smaller loans, and, as borrowers are already charged an

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additional 25 basis points for these loans, they actually improve the performance of the MMI Fund and provide additional revenue. Given that loans above $625,000 comprise a small percentage of FHA's portfolio, but have significant positive attributes, policymakers may consider extending the limits until the MMI Fund is financially stable.

Also, in recent years, FHA has increased its enforcement of agency-approved lenders which Stevens said, when warranted, is certainly the right thing to do for the fund. However, given current market conditions, FHA must take a balanced approach to enforcement to guard against further credit tightening.

MBA supports **high standards** for all FHA lenders in order to protect the agency's viability, the lender's reputation, and the reputation of the industry. There must, however, be a reasonable margin for human error, especially when the error is not the cause of the delinquency or default. MBA would staunchly oppose efforts that allow FHA to go beyond reasonable standards of lender enforcement.

Stevens also suggested some of the recent regulatory changes will affect FHA. The new definition of **Qualified Mortgage** establishes a safe harbor for lenders and Stevens said MBA strongly believes that for the foreseeable future lenders will be extremely wary of originating loans that fall outside of the QM safe harbor. Consequently, if the threshold is not at least expanded, the availability of FHA credit for underserved populations - first-time, minority, and low- and moderate-income borrowers - may be unduly limited, jeopardizing FHA's ability to fulfill its important role.

The Dodd-Frank risk retention rule as currently drafted would require families to make a 20 percent downpayment and meet relatively low DTI and other stringent requirements. The proposed QRM definition appears to conflict directly with the Administration's plan to shrink FHA from its current role of financing one-third of all mortgages and one-half of all purchase mortgages because it would make it far more difficult for private capital to re-enter the housing finance market. The wide disparity between FHA's downpayment requirement of 3.5 percent and the QRM requirement of 20 percent would force over-utilization of FHA and other government programs.

Thomas told the Senators that, **without the FHA**, the housing downturn and economic recession would have been far worse for the nation. "FHA helped fill the void over the past five years after private lending fled the market by providing safe, affordable access to mortgage credit to millions of Americans who wanted to purchase a home. Had FHA not stepped in to fill the market gap, many families would have been unable to purchase homes, current homeowners would have experienced far greater drops in equity and their home's value, and our nation's economy would be much further from a recovery."

Thomas said that FHA has always been a staple in home financing; never offering risky products, using predatory lending practices, or engaging in exotic underwriting. Yet, like all lenders, it incurred great financial losses as a result of overall market conditions that led to millions of foreclosures.

NAR is confident, Thomas said, that FHA has already taken many of the necessary steps to stabilize the fund as well as numerous administrative changes to mitigate risk. "FHA currently has one of the strongest books on record and the quality of borrowers has skyrocketed; continued market improvements and rising home prices will also help improve the fund's future financial condition," he said.

He **cautioned** about making arbitrary changes to FHA, such as further increasing costs to consumers or limiting the use of the program to certain types of buyers, only for the sake of luring back private markets.   Any actions designed to deliberately lower FHA's market share could disrupt the availability and affordability of mortgage credit and undermine the fragile real estate recovery, he said.

NAR welcomes a time when FHA's market share is reduced to its more traditional levels of 10 to 15 percent of the market, and the private lending market is once again robust, Thomas said, but we are not there yet. "Uncertainty about pending financial regulations and the future of the secondary mortgage market are keeping private lenders from returning to mortgage markets.

"Once the rules for mortgage finance are resolved and housing prices stabilize nationwide we anticipate that private investors will return to the market and FHA's market share will return to more traditional levels."

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