

Federal Housing Administration

By Melissa Stegman, Senior Policy Counsel and Mike Calhoun, President, Center for Responsible Lending

PROGRAM SUMMARY

The Federal Housing Administration (FHA) insures mortgages made by lenders, and in doing so, helps provide single-family housing and multifamily housing for low- and moderate-income families. The FHA was established in 1934 under the “National Housing Act” to expand homeownership for working class Americans, broaden the availability of mortgages, protect lending institutions, and stimulate home construction. In 1965, the FHA was consolidated into HUD’s Office of Housing. FHA is now the largest part of HUD. The FHA Commissioner reports directly to the HUD Secretary.

The FHA provides mortgage insurance to lenders on both single-family dwellings (one to four units) and multifamily dwellings (five units or more). HUD’s single-family programs include mortgage insurance on loans to purchase new or existing homes, condominiums, manufactured housing, houses needing rehabilitation, and for reverse equity mortgages to elderly homeowners. HUD’s multifamily programs provide mortgage insurance to HUD-approved lenders to facilitate the construction, substantial rehabilitation, purchase, and refinancing of multifamily housing projects.

FHA programs do not lend money directly, but instead insure private loans made by FHA-approved lenders. When a loan defaults, lenders make a claim to the FHA, triggering an FHA payment to the lender for the claim amount. The FHA consists of two insurance funds supported by premium, fee, and interest income, congressional appropriations if necessary, and other miscellaneous sources.

HISTORY

The FHA was created as an essential component of New Deal legislation in order to rescue the home building and finance industries that had crashed during the Great Depression. Upon its founding, FHA played a critical role in alleviating the homeownership crisis in the United States. However, it also played a major role in institutionalizing and perpetuating segregation in the housing market through its practice of denying mortgages based on race and ethnicity. From its inception in 1934, FHA explicitly practiced a policy of redlining by refusing to insure mortgages in or near African American neighborhoods. FHA relied upon color-coded metropolitan maps to indicate where it was considered safe to insure mortgages. These maps denoted risky areas in red; areas that included African Americans or where African Americans lived nearby. In FHA’s 1936 Underwriting Manual, numerous provisions indicated that “inharmonious” racial groups should not live in the same communities. Moreover, FHA subsidized the mass-production of subdivisions where builders included a requirement that no homes be sold to African Americans. Housing discrimination became unlawful in 1968 with passage of the “Fair Housing Act,” but much of the damage had been done. The FHA subsidized the cost of homeownership for whites and enabled whites to build wealth through home equity, while denying African Americans the same opportunity. FHA’s investment in homeownership opportunity for white families is the foundation of today’s racial wealth gap where white families have ten times the wealth of African Americans and eight times the wealth of Latinos.

Role of FHA

The FHA plays a key countercyclical role in the mortgage market and FHA’s market share varies with economic conditions and other factors. For instance, in the aftermath of the financial crisis

and the contraction in available mortgage credit, FHA insured a much higher share of single-family mortgages, increasing from approximately 3% in 2005 to a peak of 21% in 2009. FHA's market share has decreased since that time, but it remains higher than it was in the early 2000s, currently at approximately 17%.

FHA insurance allows borrowers to purchase a home with a lower down payment than is often available in the conventional market. FHA borrowers are required to make a minimum down payment of 3.5%.

FHA-insured mortgages also play an important role in providing access to homeownership for first-time homebuyers, low- to moderate-income homebuyers, and homebuyers of modest wealth. Furthermore, FHA is a key source of affordable home loans for families of color, providing nearly half of all home purchase loans for these borrowers, including upper income families of color. This is a key policy issue. It is critical to support FHA, while also advocating for the conventional mortgage market, particularly the government sponsored enterprises (GSEs), to do more to serve communities of color and lower-wealth borrowers.

Mutual Mortgage Insurance Fund

The Mutual Mortgage Insurance (MMI) Fund is a federal insurance fund that pays claims on losses from FHA-insured home mortgages. This includes forward as well as reverse mortgages, also known as Home Equity Conversion Mortgages (HECM). The MMI Fund has a statutory capital ratio requirement of 2%. The fund receives upfront and annual premiums collected from borrowers, as well as net proceeds from the sale of foreclosed homes. Each year, the MMI Fund pays out claims to lenders and covers administrative costs without federal subsidies. Under FHA's authorizing statute, all of FHA's revenue must go to the MMI Fund and cannot be used to support operations.

Borrowers pay a premium for FHA insurance. For single-family loans, this premium consists of an upfront amount collected at the time the mortgage is closed and an annual premium that

varies with the loan-to-value ratio and length of the mortgage. The annual premium is collected with the monthly mortgage payments. Currently, a borrower must pay the annual premium for the life of the loan. The premium does not end once the outstanding principal balance reaches 78% of the original principal balance. This contrasts with private mortgage insurance coverage in the conventional market.

Furthermore, FHA insures loans in amounts under set loan limits. The "National Housing Act," as amended by the "Housing and Economic Recovery Act of 2008," sets single-family forward loan limits at 115% of median house prices, subject to a floor and a ceiling on the limits. FHA calculates the limits by metropolitan statistical area (MSA) and county. These limits are updated each year and are influenced by the conventional loan limits set by Fannie Mae and Freddie Mac. FHA loan limits in 2019 ranged from \$314,827 to \$726,525, depending on geographic location. The mortgage amount also cannot exceed 100% of the property's appraised value.

Additionally, a unique characteristic of FHA loans is that they are assumable. In other words, the outstanding mortgage and its terms can be transferred to a new buyer. This feature may become more important if interest rates rise in the future. For FHA loans after December 14, 1989, the original lender must review and approve the creditworthiness of the buyer.

Special Risk Insurance and General Insurance Funds

In addition to the MMI Fund, FHA operates a Special Risk Insurance and General Insurance Fund, which insure loans used for the development, construction, rehabilitation, purchase, and refinancing of multifamily rental housing, nursing home facilities, and hospitals. Unlike the MMI Fund, this insurance requires subsidies from the federal budget.

Mortgagee Review Board

The Mortgagee Review Board is authorized to take administrative action against FHA-approved lenders that are not in compliance with FHA lending requirements. The Board can impose

civil money penalties, probation, suspension, and issue letters of reprimand. For serious violations, the Board can withdraw a lender's FHA approval so the lender cannot participate in FHA programs. The Board can also enter into settlement agreements with lenders to bring them into compliance.

Manufactured Housing

FHA provides insurance for the purchase or refinancing of a manufactured home, a loan on a developed lot on which a manufactured home will be placed, or a manufactured home and lot in combination. The home must be used as the principal residence of the borrower.

Ginnie Mae

The Government National Mortgage Association (Ginnie Mae), is a self-financing, wholly owned government corporation within HUD. Ginnie Mae guarantees the timely payment of principal and interest on privately issued securities backed by FHA, the HUD Office of Public and Indian Housing, the U.S. Department of Veterans Affairs (VA), and the U.S. Department of Agriculture's Rural Housing Service mortgages, thereby enabling a constant flow of capital for mortgage loans. Ginnie Mae securities carry the full faith and credit guaranty of the United States government. Ginnie Mae does not insure lenders against borrower credit risk; it also does not buy or sell loans or issue mortgage-backed securities (MBS). Rather, lending institutions originate eligible loans, pool them into securities, and issue Ginnie Mae MBS.

FORECAST FOR 2020

According to HUD's [FY2019 annual report to Congress](#) on the financial status of the MMI Fund, the capital ratio for FY2019 was 4.84%, the highest level since FY2007. Still, there is discussion about constricting access to credit for FHA borrowers, including potentially introducing a risk-based pricing system. FHA pools risks consistent with its role as a government mortgage insurer. Moving to a risk-based pricing system would disrupt the cross-subsidy and greatly increase the cost of credit for those with less

wealth for a down payment or lower FICO scores, pricing out many of the creditworthy borrowers FHA currently serves. In addition, some have called for further targeting of FHA's programs.

Furthermore, despite FHA's financial success, it is operating with an antiquated technology system. The mainframe system is more than 40 years old and runs an obsolete programming language. FHA's origination system has in a single year broken down 73 times, with outages lasting as long as five days. Because of the problematic computer systems, FHA relies heavily on paper records. These paper systems create slow and ineffective processes that harm borrowers, including borrowers seeking loan modifications to save their homes. There are continuing efforts to commit federal appropriations to help FHA upgrade its systems.

Housing Finance Reform

Although much of the policy discussion regarding the future of housing finance reform has centered on Fannie Mae and Freddie Mac, FHA and Ginnie Mae are integral components of the housing finance system. On March 27, 2019, the president issued a memorandum directing the Secretary of Treasury and the Secretary of HUD to develop a plan for administrative and legislative housing reforms. Along with Treasury, HUD released its [plan](#) on September 5, 2019. One of the major themes is that FHA and the Federal Housing Finance Agency should coordinate to ensure that the GSEs and FHA serve defined roles within the marketplace.

The majority of HUD's recommendations may be achieved administratively and do not require legislation. However, there is concern that the administration may limit the effectiveness of FHA and create permanent market bifurcation despite federal fair lending requirements. Advocates should continue to monitor various issues and potential changes, including:

- Changes to the structure of FHA (e.g., reconstituting it as an autonomous government corporation);
- Increases to the 2% capital ratio for the MMI Fund;

- Technology funding to upgrade FHA’s antiquated systems;
- Instituting risk-based pricing for single-family borrowers;
- Changes to upfront or annual premiums;
- Changes to down payment assistance programs;
- Altering FHA’s footprint, such as limiting cash-out refinances, conventional-to-FHA refinances, and loans to FHA repeat borrowers;
- PACE loans;
- FHA servicing and loss mitigation; and
- The Distressed Asset Stabilization Program (DASP).

“False Claims Act” Reform

FHA recently reformed its lender and loan-level certifications as well as created a Defect Taxonomy, which categorizes loan defects of various severities with remedies. These changes are intended to clarify lender liability for loan defects in the origination process and assuage lender concerns about “False Claims Act” liability for minor errors. In addition, on October 28, 2019, HUD and the Department of Justice entered into a memorandum of understanding regarding the use of the “False Claims Act” against participants in FHA single family mortgage insurance programs. Advocates should monitor potential changes to FHA’s quality control processes (including to the Defect Taxonomy), Mortgagee Review Board administrative actions, and any potential “False Claims Act” cases.