

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 (however, as described below, only white Americans benefited in the first decades of the program), 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. In the first 35 years of the FHA program, only 2% of FHA-insured mortgage loans went to borrowers of color. 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. Borrowers of color, including upper income families, are disproportionately served by government-insured housing programs, including FHA and VA, and recent HMDA data indicates low levels of conventional loans to borrowers 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 2021 range from \$356,362 to \$822,375, 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.

COVID-19 and Loss Mitigation

In the wake of the COVID-19 pandemic and economic crisis, Congress passed the "Coronavirus Aid, Relief, and Economic Security Act (CARES Act)." Among other things, the CARES Act provided for mortgage forbearance for federally backed residential single-family loans, including loans insured by FHA.

An FHA borrower experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency may request forbearance regardless of delinquency status. The borrower must submit a request to the borrower's servicer and affirm that the borrower is experiencing a financial hardship during the emergency. No documentation is required.

The forbearance must be granted for up to 180 days and must be extended for an additional 180 days upon the borrower's request. During forbearance no fees, penalties or additional interest is permitted to accrue on the borrower's account.

As of this writing, FHA has extended the moratorium on foreclosures to February 28, 2021. In addition, FHA is allowing lenders to approve FHA borrowers impacted by the COVID-19 pandemic for an initial COVID-19 forbearance through February 28, 2021.

FHA has several loss mitigation options for owner-occupant borrowers, including:

- COVID-19 Standalone Partial Claim.
- COVID-19 Owner-Occupant Loan Modification.
- Combination Partial Claim and Loan Modification.
- COVID-19 FHA Home Affordable Modification Program Combination Loan Modification and Partial Claim with Reduced Documentation.

A Partial Claim is a no interest junior lien secured by the property which is used to pay the balance owed for the suspended mortgage payments. No payments are due on the COVID-19 Standalone Partial Claim until the payoff, maturity, or acceleration of the FHA-insured mortgage,

including the sale of the property, a refinance, or the termination of FHA insurance on the mortgage.

FORECAST FOR 2021

According to HUD's [FY2020 annual report to Congress](#) on the financial status of the MMI Fund, the capital ratio for FY2019 was 6.10%, increasing by 1.26 percentage points over FY2020. The forward mortgage portfolio achieved a 6.31% capital ratio, offsetting the financial challenges of the Home Equity Conversion Mortgage portfolio, which had a negative capital ratio of 0.78%.

Impact of COVID-19 crisis on FHA borrowers

The economic crisis has hit FHA borrowers particularly hard, as low- to moderate-income borrowers and borrowers of color are more likely have a government-insured loan, and these groups generally have less wealth and disproportionately hold jobs that have borne the brunt of job loss. Furthermore, many of these borrowers were hardest hit by the Great Recession and many never fully recovered, including Black and Latino communities that loss over \$1 trillion in wealth, despite many in those communities qualifying for safer and less expensive credit.

Additionally, forbearance rates have been considerably higher for FHA borrowers than GSE borrowers. Toward the end of 2020, forbearance rates for Ginnie Mae loans were 7.83%. However, FHA has not released as much detailed forbearance data as the GSEs, so it has been difficult to determine the extent of the impact on communities of color and other demographic groups. Data transparency is key to better understood who is being impacted, what loss mitigation options various borrowers utilize, and how policymakers, industry, and advocates can help create beneficial solutions for borrowers.

Advocates continue to be deeply concerned about the millions of borrowers who have suffered job loss, reduced wages, and other economic impacts that will persist beyond the period of eligible forbearance per the CARES Act. Many are calling

for extended forbearance options.

Moreover, several lenders reduced or eliminated their FHA lending even before the current health and economic crisis hit, and more lenders followed the trend with the onset of COVID-19. Access to credit has tightened at a time that interest rates are at historic lows and previous research from the Urban Institute shows that the mortgage market could have seen 1 million more loans annually if credit was not unnecessarily constricted.

Important Issues to Monitor

While FHA's loss mitigation policies and efforts to stave off a foreclosure crisis will be front of mind in 2021, advocates should continue to monitor other critical issues, including:

- The lack of rate refinance options for low-wealth borrowers despite robust refinancing opportunities for wealthier families with conventional mortgages that is being driven by ongoing support to the mortgage market from the Federal Reserve's bond purchase program;
- Maintaining level pricing for single family borrowers;
- Changes to underwriting standards and the FHA TOTAL Scorecard, including recent efforts to restrict higher debt-to-income loans;
- Continuing efforts to commit federal appropriations to help FHA upgrade its antiquated technology (FHA is in year three of five of a massive overhaul of its systems);
- Changes to upfront or annual premiums to ensure greater affordability for FHA borrowers;
- Ensuring down payment assistance programs remain available and fairly priced for potential homebuyers. A large percentage of FHA loans utilize down payment assistance programs, some of which operate as grants and others require or offer an increase in the interest rate. It is key for borrowers to shop around to ensure they do not overpay for down payment assistance;

- Efforts to allow Property Assessed Clean Energy (PACE) loans, which permit a homeowner to finance the upfront cost of energy efficiency improvements on the property and pay back the costs through property tax assessments (such arrangements raise numerous consumer protection concerns);
- Changes to the Distressed Asset Stabilization Program (DASP), which sells severely delinquent FHA loans to investors; and
- Upgrading FHA servicing and loss mitigation to mirror the GSEs as appropriate.

“False Claims Act” Reform

In 2019, FHA 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 were 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. Moreover, advocates should monitor if banks that previously exited the FHA program begin to offer FHA loans again.