FHA Premium Reductions

Key Points:

- FHA saved the economy during the recent great recession
- Lowering FHA premiums will increase homeownership for first time homebuyers and minorities
- Premium decreases do not affect the solvency of the MMIF
- MMIF is strong and getting stronger but growth is held back by lack of volume
- High premiums hurt consumers and the fund and are unnecessary

Background on FHA

Since its creation in 1934, FHA has been charged with ensuring that American families have access to safe, affordable mortgage credit. The FHA mortgage insurance program allows private lenders to offer reasonable rates and terms to qualified families who want to purchase a home of their own. Like banks and other financial institutions, FHA incurred losses as a result of the housing crisis. Over the last several years, FHA has taken a number of steps to remain financially stable. These include increasing premiums 5 times in the last 2 years, increasing downpayments on some borrowers, and increasing its risk management practices. The goal of increasing the premiums has been to increase revenue. But now the historically high premiums are negatively impacting the Mutual Mortgage Insurance Fund (MMIF), and are overcharging American families.

FHA Saved the Economy during the Great Recession

More recently, FHA prevented a complete collapse in the house sector, likely saving us from a double-dip recession. As private investors retreated from the mortgage sector in the wake of the worst housing crisis since the Great Depression, the FHA increased its insurance activity, to keep money flowing into the market. Without FHA's role, housing markets would have completely collapsed. Home prices would have plummeted even further, loss of household wealth would have been catastrophic, and even more families would have lost their homes to foreclosure. By one estimate, the FHA prevented prices from dropping an additional 25 percent, which in turn saved 3 million jobs and half a trillion dollars in economic output.

MMIF is Strong and Getting Stronger but Growth is Held Back Due to Lack of Volume

The 2014 Annual Report on the MMIF showed that the Fund has improved by $6 billion over the last year and by $21 billion over the last two years. The profile of FHA borrowers remains strong and the fund is performing well. Borrowers with credit scores above 720 made up 17 percent of all borrowers in FY2014, and borrowers with credit scores below 620 were less than 5 percent of all loans. In FY2014, delinquency rates declined by 14 percent, and seriously delinquent rates dropped by 30 percent.

While the Fund is showing remarkable progress, the results are less positive than were expected. The reason is simple – FHA is pricing itself out of the market, and losing the very best - qualified households that would have traditionally used the program and the attendant revenue that would quickly bring it back to its required 2 percent reserves. Today, there are not enough borrowers to increase revenue at predicted levels.

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In addition, the performance of the Home Equity Conversion Mortgage (HECM, also called reverse mortgage) program has had a significantly negative impact on the Fund. FHA has changed the parameters for this program, and placed stringent new guidelines on these loans.

FHA Premiums Remain Higher Than Needed For Risk

With the premium reduction, the total fees charged to borrowers remain at 6 percent of the originated balance of the loan (estimated as an upfront price). This more than covers the expected losses to the Fund, and allows excess fees to continue to build up the capital reserve to its required minimum of 2 percent.

High Premiums Hurt Consumers and the Fund

In 2014, FHA fees made up nearly 20 percent of a monthly mortgage payment. On a $150,000 loan at 4.5 percent interest, the mortgage payment was 13 percent higher than it was in 2008. The rate reduction will result in 90,000 to 140,000 additional annual home purchases from credit worthy buyers who would otherwise be on the sidelines because they are not being served in the conventional mortgage space and have been priced out of the market due to high FHA fees.

In addition, significant numbers of well-qualified FHA borrowers have been prepaying their mortgages to get out of this charge, which has had a negative impact on the Fund. According to HUD's data, full payoffs, with no subsequent refinance with FHA, were 81 percent of FHA's prepayments.[1] In 2012, only 50 percent of FHA prepayments were full payoffs. Prepayments in FY 2013 were at their highest level since the end of FY 2004 despite historically low interest rates.

The previous year's report anticipated an additional $57 billion of business. The shortfall can easily be explained by the older lower quality loans still on the books and high prices that are keeping qualified borrowers out of the market. The MMIF itself performed very well. Early delinquencies dropped more than expected, as did the number of serious delinquent loans. FHA simply didn't have as many borrowers as expected.

Lowering Premiums Makes Sense

In much the same way that lowering tax rates increases revenue to the Treasury; reducing FHA's premium rate will increase FHA's revenue. The .50 percent reduction in the annual rate will result up to 140,000 more home purchases annually. These qualified borrowers will help the Fund as well as the economy, and ensure FHA reaches the 2 percent capital reserve promptly.

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[1] U. S. Department of Housing and Urban Development (HUD) Office of Risk Management and Regulatory Affairs, Office of Evaluation, Reporting and Analysis Division, *FHA Production Report*, December 2013.