Insight

4 Reasons Taxpayers Should Be Wary of Executive Action on Housing

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In a speech today in Phoenix, President Obama is expected to announce a reduction in Federal Housing Administration (FHA) annual premiums of 50 basis points, the latest in a concerted effort to expand credit availability. With recent pressure from affordable housing advocates, the announcement comes as no surprise. Yet this case of political pandering has serious policy implications. While a premium reduction certainly has its supporters, it does not come without a cost. Here are four things to remember as the President lays out his plan:

1. FHA is not in compliance with its congressionally mandated capital ratio.

Buoyed by mortgage settlement money, higher premiums, and other programmatic changes, the capital ratio has rebounded to 0.41 percent in FY 2014 from -1.44 percent in FY 2012. Yet the capital ratio is still well below the 2 percent threshold meant to help protect taxpayers from potential losses. Lowering premiums, which lowers revenue, will likely further delay a return to the capital ratio's mandated level.

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Furthermore, legislation introduced in the last Congress proposes to further insulate taxpayers by raising the capital cushion at the FHA. For example, the bipartisan S. 1376[1], the "Fiscal Solvency Act of 2013," would raise FHA's mandated capital reserve ratio to 3 percent, a level the MMIF is not currently projected to reach until 2018. The PATH Act in the House would raise it even higher to 4 percent[2], which FHA is not projected to achieve until 2019.

2. FHA has a documented history of missed projections.

Indications that the announced premium reduction will have little effort on FHA's ability to meet its capital ratio should be taken with a grain of salt. FHA's recent history has been plagued by missed projections and this year was no different. For many, this enhances the perception that FHA downplays risks borne by taxpayers and casts doubt on the assumption that FHA will continually improve as projected. Since FY 2009, FHA's capital ratio has been below the 2 percent minimum mandated by Congress. FHA has repeatedly projected marked improvement only to miss its targets (See Figure 1). Furthermore, in every actuarial review since 2004, the economic value of FHA's single family fund has come in lower than what was projected the previous year (See Figure 2). While FHA has in the past pointed to programs like Home Equity Conversion Mortgages (HECM) or the prevalence of seller-funded down payment assistance for losses greater than anticipated, inaccurate forecasting of increased house price growth, higher interest rates and higher volumes are more frequently to blame. The decreased revenue that will result from lowering of premiums puts FHA's future projections of profitability into murkier territory.

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3. Failure to restore FHA's capital ratio puts the work FHA does at risk along with taxpayers.

While many programmatic and operational changes have been made to FHA, concerns over whether FHA can weather another economic downturn are unlikely to dissipate, particularly if its capital buffer is not soon restored at least to the minimum level mandated by Congress. While job growth has been recently strong, the economy must still grapple with headwinds from Europe, concern over plummeting oil prices, a still sluggish housing sector, and the fundamental lack of wage growth. Furthermore, the economy has grown slowly since the recession ended in June 2009; yet the current period of economic expansion, 67 months long, already exceeds the average expansion period since World War II of 58 months. While another recession may not be imminent, one is inevitable. The capital buffer protects taxpayers in such a downturn while preserving FHA's ability to fulfill its mission. Simply, further delay puts the program and taxpayers at risk.

4. Lowering premiums acts contrary to reducing the government's role in housing.

The outsized role the government plays in housing continues to be a primary bipartisan concern. While more serious reforms to limit FHA's mission may come with housing finance reform legislation, increased FHA premiums have helped reduce FHA's market share, which continues to fall slowly from its peak of about 30 percent, and allow capable private market participants to compete. Premium reductions, along with FHFA's recently announced low down payment plan, make government-backed mortgage products more attractive to potential borrowers, but run counter to the widely expressed desire to limit the government's role in housing markets.

[1] S. 1376, §9; http://thomas.loc.gov/cgi-bin/query/D?c113:2:./temp/~c113yUGpwj::