



Insight

Costly Midnight Premium Cuts May Be Coming from FHA

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Rumors are circulating of an imminent cut in Federal Housing Authority (FHA) mortgage insurance premiums – perhaps even before Obama leaves office and via an announcement in current Housing and Urban Development (HUD) Secretary Julian Castro’s farewell address. Recall that the last premium cut in January 2015 was 50 basis points (bps) and by August, FHA was already seeing a [173 percent increase in refinanced single family mortgages](#) as a result of the mortgagees refinancing to take advantage of the lower premium. Notice this is unambiguously bad news for the financial condition of the FHA: the same risk remains on the books, but less revenue is available to cover losses. For a program that is already woefully undercapitalized ([hovering around 2 percent](#), depending on what is factored in – for comparison’s sake, the minimum capital requirements set by the Federal Reserve for banks is 4.5 percent), losing revenue while maintain risk is not a good thing.

If Castro does in fact announce a premium cut in his farewell address, it will likely be a reduction between 25 and 30 bps. According to the [FHA Mutual Mortgage Insurance Fund’s \(MMIF\) most recent annual report](#), the program saw \$13,196,000,000 in incoming cash flow in FY 2016. If that revenue is reduced by 25 bps, the MMIF stands to lose \$32,990,000 annually. If premiums are reduced by 30 bps, it will lose \$39,588,000 annually. That’s not chump change. Consider the fact that the administration has published [425 so-called midnight regulations totaling \\$21.7 billion](#) since election day. If either premium reduction were to go through, their costs would fall as the 113th most costly regulation announced on the administration’s way out.

But the tangible costs aren’t the only concern. The outsized role the government plays in housing finance continues to be a primary, bipartisan concern, and lowering FHA premiums will exacerbate the problem. The effort will expand FHA’s market share by making its mortgage insurance cheaper for borrowers than what is offered by private insurers. A 25 or 30 bp reduction allows FHA to undercut conventional pricing for most low-downpayment (i.e. high loan-to-value) mortgages and those for borrowers with lower credit scores – loan characteristics generally recognized as having greater inherent risk.

In short, reducing FHA premiums incentivizes the least qualified buyers to use the federal government’s services to obtain a mortgage backed by the taxpayers. It also incentivizes current homeowners with FHA mortgages to refinance in order to get themselves a lower rate while sticking FHA with an equal amount of risk of loss. If this is starting to sound familiar, it should. The most recent financial crisis was caused in large part by FHA, Fannie Mae, and Freddie Mac lowering lending standards and expanding their lending to the least qualified borrowers.

Secretary Castro and the incoming administration should take a lesson from history and not further reduce FHA premiums – at least not until the MMIF is adequately capitalized to ensure taxpayers won’t be bailing out the housing industry again.