Insight

Reviewing The Financial Health Of The FHA

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The Federal Housing Administration's (FHA) annual audit has been released, reporting that its Mutual Mortgage Insurance Fund (MMIF) is back in the black but further away from its congressional mandate than anticipated. For the past few years, annual actuarial reviews have provided Congress and private stakeholders with critical insight into the FHA's financial health. FHA sustained heavy losses on business conducted in the aftermath of the housing crisis, a time when FHA's market share dramatically increased to fill the void left when private mortgage insurers pulled back. FHA depleted its capital reserves and required $1.7 billion from the Treasury Department last year to bolster its finances. Its weakened fiscal state led to increased scrutiny and calls for reform.[1] This year's actuarial review showed improvement, but not enough to assuage critics' concerns or yet warrant premium reductions. Here's what you need to know about the report:

Background on MMIF's Current Status

Since FHA's 2009 audit showed its capital reserve ratio had fallen below the congressionally mandated threshold of 2 percent, FHA has made numerous changes to its programs and operations, including premium increases, detailed in Table 1. The capital ratio represents the economic value of the MMIF (essentially capital reserves added to expected revenues less losses) as a percentage of FHA's total insurance-in-force.

TABLE 1. SUMMARY OF NOTABLE ANNOUNCED STEPS TAKEN TO BOLSTER FHA'S MMIF	
APRIL 2009	INCREASED ON-SITE LENDER INSPECTIONS
NOVEMBER 2009	CAPITAL RATIO FALLS TO 0.5 PERCENT NPR: APPROVED MORTGAGE LENDER CHANGES
JANUARY 2010	CREDIT POLICY/APPRAISAL CHANGES TO REDUCE RISK INCREASED ENFORCEMENT ON LENDERS
APRIL 2010	50 BP INCREASE IN UFMIP*
MAY 2010	FR: APPROVED MORTGAGE LENDER CHANGES CORRECTED FR: MORTGAGE LENDER CHANGES EFFECTIVE

JULY 2010	RFC: REVISED SELLER CONCESSIONS, LTV/FICO REQUIREMENTS, & MANUAL UNDERWRITING ENHANCED MULTIFAMILY RISK MANAGEMENT/OVERSIGHT
OCTOBER 2010	FR: LTV/CREDIT SCORE REQUIREMENT EFFECTIVE NPR: LENDER ELIGIBILITY, INDEMNIFICATION, & TERMINATION CHANGES
NOVEMBER 2010	CAPITAL RATIO STAYS 0.5 PERCENT
APRIL 2011	25 BP INCREASE IN ANNUAL MIP
NOVEMBER 2011	CAPITAL RATIO FALLS TO 0.2 PERCENT
FEBRUARY 2012	FR: LENDER ELIGIBILITY, INDEMNIFICATION, & TERMINATION CHANGES EFFECTIVE NPR: REVISED SELLER CONCESSIONS & CORRECTED NPR
APRIL 2012	10 BP ANNUAL MIP INCREASE REQUIRED BY TEMPORARY PAYROLL TAX CUT CONTINUATION ACT OF 2011, 75 BP INCREASE IN UFMIP & NEW PREMIUM STRUCTURE
JUNE 2012	25 BP ANNUAL MIP INCREASE FOR MORTGAGES EXCEEDING $625,500
AUGUST 2012	FR: APPROVED MORTGAGE LENDER CHANGES CLARIFYING PREVIOUS FR
NOVEMBER 2012	CAPITAL RATIO FALLS TO -1.4 PERCENT REVISION OF LOSS MITIGATION OPTIONS
FEBRUARY 2013	RFC: MAXIMUM LTV PROPOSAL
APRIL 2013	HECM CONSOLIDATION 10 BP INCREASE IN ANNUAL MIP FOR MOST BORROWERS MANUAL UNDERWRITING FOR < 620 FICOS & 43+ PERCENT DTI RATIO
JUNE 2013	REVISION OF POLICY REGARDING CANCELLATION OF ANNUAL MIP AT 78 PERCENT LTV
JULY 2013	RFC: FHA'S QUALITY ASSURANCE PROCESS
AUGUST 2013	REVERSE MORTGAGE STABILIZATION ACT OF 2013 BECOMES LAW
SEPTEMBER 2013	FURTHER HECM CHANGES

DECEMBER 2013	CAPITAL RATIO INCREASES TO -0.1 PERCENT FR: MANUAL UNDERWRITING
DECEMBER 2014	CAPITAL RATIO INCREASES TO 0.4
* Upfront Mortgage Insurance Premium Note: Notice of Proposed Rulemaking (NPR), Final Rule (FR) & Request for Comment (RFC)	

With higher premiums and other changes, FHA has profited from more recent books of business, allowing them to compensate for ongoing losses from business during the recession. FHA's audit last year projected the MMIF's capital reserve ratio to turn positive in 2014 and meet its 2 percent congressional mandate in 2015 (See Figure 1), although it has a history of missing projected targets. The same is true this year as FHA reported its capital ratio in FY 2014 to be 0.41 percent, lower than the 1.22 percent projected last year. The projected return to FHA's congressional mandated minimum has therefore been pushed back another year to 2016.

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Calls for Premium Reduction

Buoyed by mortgage settlement money, higher premiums, and other changes highlighted in Table 1, the capital ratio has rebounded to 0.41 percent in FY 2014 from -1.44 percent in FY 2012. Recent improvement has led to speculation as to whether significant improvements in FHA's finances in the upcoming actuarial review would push officials to lower mortgage insurance premiums. Affordable housing advocates had called on HUD Secretary Castro to push for a reduction in annual premiums from 135 basis points (bp)[2] to 75 bp if the actuarial report showed FHA on track to meet its 2 percent capital ratio by the end of 2015, claiming lowered premiums would only slightly delay that return.[3] A reduction in annual premiums over the upfront mortgage insurance premium (UFMIP) would more significantly affect FHA's future revenue stream.

FHA's failure to meet last year's projection may bolster the argument that it is too soon for premium reductions. FHA critics are still likely to insist any reduction in premium reductions come after FHA meets its congressional mandate, if decreased at all. Furthermore, legislation previously introduced in Congress like S. 1376[4], the "Fiscal Solvency Act of 2013," would raise FHA's mandated capital reserve ratio to 3 percent, a level the MMIF is not projected to reach until 2018. The PATH Act in the House would raise it even higher to 4 percent[5], which FHA is not projected to achieve until 2019.

FHA must have sufficient capital to minimize taxpayer loses in a downturn, but also to continue to serve its mission of helping first-time and low-income borrowers buy a home. The recently proposed Homeowners Armed With Knowledge (HAWK) program, which would allow first-time buyers who go through housing counseling to receive premium reductions, may also have an affect of FHA's ability to meet its capital ratio mandate quickly.[6] However, that would depend on the scope and pricing of the pilot program FHA implements following the recent period of public comment.

Will an Improved Fiscal State Mollify Critics?

Not likely, for a few reasons.

1. FHA's recent history has been plagued by missed projections and this year is no different. 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 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.

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2. 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 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 foreign markets, a sluggish housing sector, and a 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, 70 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.

3. Conservatives continue to be weary of the outsized role the government plays in housing. 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. A significant reduction in premiums would make FHA more attractive to potential borrowers, but would run opposite of the widely expressed desire to limit the government's role in housing.

[1] See: Jason Gold & Andy Winkler, "Guidelines for Federal Housing Administration Reform," (March 2013); http://americanactionforum.org/sites/default/files/PPI AAF FHA.pdf