THE HILL

The Federal Housing Administration, the next housing crisis?

By Tom Schatz, March 16, 2015

Two oversight hearings on the Federal Housing Administration (FHA) have helped shed light on an agency that runs a $1 trillion mortgage insurance program originally designed to help low- and moderate-income individuals buy a house if they cannot provide a 20 percent down payment. The FHA is the largest single provider of mortgage insurance and provides a 100 percent guarantee of payment to lenders should the homeowner default.

The House Financial Services Committee heard testimony from Housing and Urban Development Secretary Julian Castro on Feb. 11 and the Housing and Insurance Subcommittee heard from several witnesses on Feb. 26.

On the day of the second hearing, Citizens Against Government Waste named Castro the February "Porker of the Month" for, among other reasons, "planting the seeds for the next major housing bailout and failing the most basic financial transparency test about FHA finances."

When queried by members of the committee about the January 2015 premium reduction as well as the FHA's precarious financial status, Castro was at pains to provide even basic information about the current value of the FHA portfolio. He also refused to admit that the FHA was operating outside of the law, could not say when it would achieve the 2 percent capital reserve benchmark and repeatedly delivered a series of meaningless platitudes about the benefits of homeownership. Rep. Scott Garrett (R-N.J.) pointed out that the FHA has offered "pricing gimmicks" while lowering its credit standards, down payment requirements and premiums, which are tactics that have been criticized elsewhere as "predatory lending."

Ironically, on the same day that Castro testified, the FHA was once again included on the Government Accountability Office's *High Risk List* due to the agency's "substantial growth in its insurance portfolio and significant financial difficulties." The FHA has been on the list since 2009.

Historically, the FHA has controlled about 10 to 20 percent of the mortgage market. But after Congress increased the size of mortgages the agency could insure from $360,000 to $625,000, the FHA controlled about 60 percent of the low down-payment mortgage market from 2008 to 2010. That means the income eligible for FHA mortgage insurance went from the national average of about $64,000 to $110,000. Put another way, more than twice as many people can get FHA insurance than they could before the limit was raised.

At the same time that eligibility has exploded, FHA has faced serious solvency problems, culminating in a $1.7 billion bailout from the U.S. Treasury at the end of 2013. The Congressional Budget Office estimated that FHA insurance cost taxpayers $15 billion from 2009 to 2012. Nonetheless, the agency's website falsely claims it "is the only government agency that operates entirely from its self-generated income and costs the taxpayers nothing."

Even with all of the taxpayer money that has been thrown at the agency, the FHA is seriously undercapitalized. The law says FHA needs to keep 2 percent cash on hand, which would be about $18 to $20 billion, but as of the beginning of 2015, it had only less than half of 1 percent, or $4.7 billion.

The FHA could be self-sustaining if it charged enough in premiums and fees, but the 37 percent mortgage insurance premium cut from 1.35 to 0.85 in January 2015 makes it much harder to achieve that objective. The agency estimates that it will be sometime in 2016 before it reaches the required 2 percent capitalization.

During 2014, private mortgage insurers made headway in chipping away at the FHA's market dominance, going from rough equilibrium to recapturing about 10 percent or more of the FHA's business by year end.

However, the premium reduction makes FHA insurance cheaper and preferred for lots of borrowers who would have otherwise used private mortgage insurance. And as always, an FHA-insured loan can be transferred to a new owner when a home is sold, unlike loans with private insurance.

The FHA should return to its original mission: insuring loans for individuals of modest means, either through income tests or limits on the size of the mortgage. The private sector and private capital are perfectly capable of taking care of everything else.