Bill would help get FHA back in mortgage game

by Emmet Pierce

With the troubled subprime loan industry beset by foreclosures and tightening credit, lenders and lawmakers are attempting to resurrect a 73-year-old government program to help take up the slack.

Once a top choice for first-time home buyers and people with credit problems, loans insured by the Federal Housing Administration have lost their luster in recent years.

During the U.S. housing boom that raged between 2000 and 2005, FHA was a minor player. That's largely because FHA's lending ceiling of about $363,000 is too low for pricey markets. It doesn't begin to approach the median single-family resale home price in many areas, primarily the East and West Coasts.

In Congress, pending legislation seeks to raise the ceiling to $417,000, a move that would put FHA buyers back into the starter-home market.

The FHA program was created in 1934 to encourage loans to low- and moderate-income households by providing mortgage insurance that reduces risk to lenders. Critics say cumbersome regulations and antiquated practices now make it impossible for the agency to remain competitive.

When it failed to offer products that could help Americans keep up with rising home prices, FHA "created a vacuum where subprime lending emerged," said Nicolas Retsinas, director of Harvard University's Joint Center for Housing Studies.

Risky adjustable subprime loans became increasingly popular in high-end markets as prices rose beyond the reach of middle-wage workers. Some offered "payment option" plans that allowed borrowers to pay very little while increasing their principal debt through negative amortization. Others featured adjustable mortgages that began with low "teaser" rates that moved upward after two or three years.

FHA "has always been around," said Keith Gumbinger, vice president of HSH Associates, a mortgage information firm based in New Jersey. "Subprime kind of elbowed it out of the way ... They are lagging in the marketplace."

Now that many subprime mortgages are resetting at higher interest rates and defaults are spiking, the housing industry is looking for a way to bring FHA back into the game.

One goal of House Resolution 1852, an FHA reform bill with broad bipartisan support, is to cut the lengthy red tape that the program is known for. Another is to re-examine how the agency can live up to its legacy as a champion of the middle class.

FHA's mortgage share "has been dwindling," said David Ledford, the National Association of Home Builders staff vice president for housing finance and housing policy.

In California, FHA single-family mortgage insurance activity declined from 198,482 loans in fiscal 1999 to a scant 27,210 in fiscal 2006, the agency reported. "Mainly they are saddled with so much red tape due to statutes and regulations that they can't be as nimble and flexible as private mortgage companies," Ledford said.

The NAHB is asking lawmakers to allow FHA to extend the maximum loan maturity to 40 years to enable borrowers to reduce monthly mortgage payments.

GOOD INTENTIONS

The agency already has begun making efforts to be more competitive, said Meg Burns, FHA's director of single-family program development.

FHA is known for "a number of unique and specialized requirements that were onerous" to buyers and sellers, Burns said. "There were people here who believed the requirements were protecting the consumer, but in fact they were driving the consumer away. We had to sit down and assess what we are doing here. Are we pushing away the families that most need FHA? Do we need to make some change to bring FHA back to those folks?"

Borrowers and lenders drifted away because the agency "became very difficult to do business with," said John M. Robbins, president of the national Mortgage Bankers Association. "The lending community went into loans that essentially were easier and more consumer-friendly. They could get a loan done in a number of days" instead of weeks or even months with FHA.

Without more reforms and higher loan limits, FHA will remain a relic, said Ed Smith Jr., government affairs chairman for the California Association of Mortgage Brokers. "I haven't seen an FHA loan in years."

FHA was formed during the Great Depression to give "the average, hardworking person a chance to own a home" without the risks associated with subprime mortgages, Smith said. "What you are talking about are fixed-rate, long-term, sustainable loans."

H.R. 1852 seeks to make FHA a viable player. That could benefit consumers who need to refinance their subprime loans before interest rates shoot up. The bill has backing from major trade groups, such as the NAHB and the MBA. The co-authors in Congress are Democrats Maxine Waters of Los Angeles and Financial Services Committee Chairman Barney Frank of Massachusetts.

Joe Kaspar, communications director for U.S. Rep. Duncan Hunter, R-Calif., noted that several bills have been introduced this year to reform FHA. Similar measures have been offered by Sen. Hillary Clinton, D-N.Y., and Rep. Judy Biggert, R-Ill.

"Congressman Hunter supports efforts to ensure FHA better reflects the current realties of today's mortgage and housing markets," Kaspar said. "Congressman Hunter will more closely consider any such measure should it require his attention on the House floor."

Rep. Susan Davis, D-Calif., praised H.R. 1852. Dubbed "The Expanding Homeownership Act of 2007," the bill "would make a number of changes to the law that would help homeowners and prospective homeowners in California," Davis said. "The legislation would also take steps toward protecting borrowers from riskier or subprime loans."

HIGHER RISK

In addition to raising loan limits in costly areas like Southern California, New York and Massachusetts, the bill would permit minimal or zero down payments for qualified applicants, making FHA more competitive with private lenders. It also would allow FHA to aid borrowers with higher credit risk than those currently served.

Gumbinger said that could translate into higher lending fees to cover the greater risk of default.

Unlike many subprime mortgage programs, FHA currently doesn't allow consumers to buy a house without a down payment of at least 3 percent. Some lawmakers hope to lower that threshold.

Burns said the present low lending ceilings are the biggest obstacle to bringing FHA into the lending mainstream. "People really had no other choice but subprime," she said.

There will always be a market for subprime loans, she added. They were created to help people who have short-term credit needs. Because subprime loans were packaged as mortgage-backed securities and sold to investors during the housing boom, "Wall Street loved it, and consumers had easy access to credit."

The recent surge in subprime loan foreclosures has brought the love affair to an end. About 50 subprime lenders reportedly have left the business. The remainder are tightening the loose credit standards that triggered defaults. As a result, many borrowers have found themselves trapped in costly subprime loans.

Ledford said the subprime lending crisis could give Congress an incentive to bring FHA up to date. Some housing industry professionals already anticipate a rebound.

Real estate agents who have gotten out of the habit of dealing with FHA will have to retrain, said longtime Southern California agent Gary Kent. "We recently had a class at my office so we could get up to speed."

BEING CAREFUL

While modernizing FHA mortgage programs, Congress should be careful not to strip away its safeguards, some analysts say.

Helping troubled subprime lenders refinance with FHA-backed loans "does not change the problem," Gumbinger said. "These borrowers are just as likely to be thrown out of their homes. These borrowers are just as likely to go delinquent and be subject to foreclosure."

Burns agrees that FHA should retain sound underwriting standards. Unlike in the subprime market, FHA borrowers aren't allowed to simply state their income or receive a loan without income documentation. Burns says that's a good thing.

"FHA borrowers must be able to repay based on true underwriting," she said. There are "none of those gimmicks that make a loan look affordable ... FHA is offering a safer, more affordable alternative."