A Question Of Timing: Should The FHA Reduce Mortgage Insurance Premiums?

by Patrick Barnard
on **November 30, 2016**
Categories : E-Features

After running negative for several years, the Federal Housing Administration's (FHA) Mutual Mortgage Insurance (MMI) Fund has firmly turned the corner, having stayed in the black for a consecutive year, according to the U.S. Department of Housing and Urban Development's (HUD) annual report to Congress.

According to the report, which was released earlier this month, the fund grew by $3.8 billion during the FHA's fiscal year ended Sept. 30 and currently stands at 2.32%, up from 2.07% last year.

It was the second consecutive year that the FHA's reserve ratio exceeded the congressionally required 2.0% threshold.

The news, of course, led to cries from the housing industry that now is the time for the FHA to consider lowering its insurance premiums. The National Association of Realtors, for example, is urging the FHA "to reduce mortgage insurance premiums to better reflect the risk in the marketplace and fulfill its mission of serving low- and moderate-income borrowers," it said in a recent statement.

In 2013, the FHA raised its insurance premiums in order to offset harsh losses resulting from defaulted loans, as well as losses in its reverse mortgage program. However, in January 2015, the FHA announced it was cutting premiums by 50 basis points in order to help stimulate housing activity. This, in turn, resulted in an increase in volume that further helped bolster the fund's reserves. Although many people say now is the right time for the agency to reduce premiums again, some point to ongoing instability in the Home Equity Conversion Mortgage (HECM) program and general weakness in the economy as reasons to hold off.

To get more insight into where the mortgage industry stands on this important issue, ***MortgageOrb*** polled executives at various lending shops, including some that focus on reverse mortgages. Following are responses from A.W. Pickel, president of the Midwest division for AmCap Mortgage; Joan Imelio, vice president of the reverse mortgage division for HighTechLending; Paul Buege, chief operations officer for Inlanta Mortgage; Jean Badciong, chief compliance officer for Inlanta Mortgage; Joe Morris, senior vice president of reverse mortgage lending for Open Mortgage; Keith Canter, CEO of First Community Mortgage; Gellert Dornay, president and CEO for Axia Home Loans; Jeff Bode, CEO at Mid America Mortgage; and Brandon Story, chief strategy officer at Pacific Union Financial.

Q: Considering the FHA's recent report to Congress and the strength of the MMI Fund, which is now back to pre-crisis levels, is now the right time for the FHA to reduce insurance premiums?

Pickel: The real issue here is whether this policy is a plan that will allow more people into homes. The FHA's MMI makes up very little of a typical payment and, consequently, does not greatly affect the affordability of a mortgage. For instance, lowering the upfront mortgage insurance (MI) to 1.25% saves approximately $4 monthly. If the FHA were to allow a 40-year term, the monthly payment could decrease around $125. The increase in term would greatly enhance mortgage affordability.

Buege: If there were a time to give additional consideration to reduce FHA premiums, it may be now. A liquidity study should be completed to determine if it is necessary to maintain the MI premium for the life of the loan or for the premium to cancel once it reaches an acceptable loan to value, similar to a conforming MI. This will allow the FHA to stay impactful and competitive to the very markets it was designed to serve.

Canter: Recent statistics from September have shown home prices have risen roughly 5% over the past year. At the same time, home prices in seven of the nation's 20 largest states hit new record highs. These stats, along with the fact that interest rates have risen by roughly 0.5% since the election, are quite concerning – it appears we are moving from an affordable housing problem to an affordable housing crisis. Now would be the perfect time to reduce premiums to allow more borrowers who are being priced out of the market through a period of high demand and higher interest rates to qualify for homes.

Dornay: The decision to reduce premiums at the FHA should ride solely on its ability to strike a balance between ensuring we have a strong fund and its ability to increase the number of families that can obtain homeownership. This is a delicate balance – and one that cannot be taken lightly. But with the expectation of rising rates and continued appreciation across much of the country, every bit HUD can do to keep homeownership affordable is critical to the stabilization of our economy and our communities.

Bode: It is the correct time to reduce the single-family rates.

Story: Yes, the recent actuarial review of the MMI Fund demonstrates the health and soundness of the FHA. The 2.32% capital ratio exceeds the statutory regulatory requirement of 2.0%, and the capital ratio is projected to achieve 5.5% by 2023.

Q: What about the volatility in the HECM program? Is this a good reason to keep rates where they are currently?

Pickel: The volatility of the HECM program is greatly related to the potential claims in the future. With the restructuring of HECM a few years ago, the HECM insurance fund is much more stable. With the prospect of a growing economy and rising values, the HECM program should be fine. With a solid future ahead for the HECM program, I believe rates are currently good.

Imelio: That is a very involved question; as far as the adjustable-rate mortgages (ARMs), with the indexes increasing, it forces the margins to be reduced to meet the floor rate of 5.06%. It really only has an effect on the compensation to the originator. The same can be said about the fixed rate: We will continue to offer the floor rate and below 5.06%, but again, it will affect the compensation to the originator. I don't think we will see much volatility unless we have large movements and adjustments to overall compensation.

Morris: Yes, any more upward movement in rates could have a negative effect on the borrowers of the HECM program. It could drastically reduce the proceeds that the seniors could receive from the loan and, thus, reduce the effectiveness of the program.

Dornay: Even though there is volatility in the HECM program, one program in and of itself shouldn't dictate the direction of where rates head; instead, focus should remain on disciplined metrics that take into account the delicate balance of consistency funding capacity, while also accommodating our aging population. We hope the HECM program will continue to be a safe and effective cashflow solution for senior homeowners. Recent changes to the program, such as the financial assessment, the 60% max draw in the first year and the reduced upfront MI premium, have given the program stability and longevity. Over recent years, HUD has definitely shifted the origination attention away from fixed-rate products in favor of the versatility of the HECM ARMs. It would be nice to see some of the existing HECM ARM features, such as the line of credit and the lifetime monthly payment, become available in the fixed-rate HECM product.

Bode: This pricing should go up, as the risk of hurting the fund is greater. Greater risk comes with higher premiums.

Story: The HECM program continues to show volatility and drag down the health of the MMI Fund. It is time to revisit the Housing and Economic Recovery Act of 2008 that moved all new HECM endorsements into the MMI Fund from the General Insurance Fund. The forward mortgage capital ratio is currently at 3.28% vs. the HECM capital ratio of -6.90%. Increasing homeownership and affordability to first-time home buyers could be possible if the forward mortgage program could stand on its own.

Q: What about the coming regime change in Washington? How do you think this might affect any proposal to reduce premiums?

Pickel: With a Trump administration, what we seem to know is that there will be less regulation. I don't think at this time we know if this will decrease premiums, but I think it appears that we will have an administration that thinks like a business and will want to grow the economy. If a reduction in premiums will grow the economy, then it is likely that this administration will be for it.

Buege: The housing industry was not a platform topic in either political campaign. We really don't know what the new administration will bring to the table; however, we expect that within the first 100 days, the housing industry will not be a major focus. The new administration seems to be pro-growth, and it would seem that this administration would not make decisions that would negatively impact the housing market, which has such a significant role in the nation's economy.

Canter: Given Trump's business-like and pragmatic approach he has shown so far, I don't think it will be a matter of if, but when and how much the premiums are reduced. Congress has stated in the past that premiums must be sufficient to cover expected losses and achieve a 2% excess reserve. At the same time, the FHA guarantee should also be priced appropriately to provide a path to homeownership for the many creditworthy families still unable to obtain affordable financing through the private market. So, given the fact that the reserve is now at 2.32% and is only expected to improve due to the more prudent and stringent underwriting standards coming off the heels of the Great Recession, why would Congress not tilt its focus to the second part of the equation and help families achieve homeownership?

Dornay: Any imminent proposal to reduce premiums will likely be placed on hold pending a new regime in Washington under the direction of a new HUD director. Regardless of the new director, Republican leadership might hesitate to further subsidize housing and keep costs higher, with the goal of encouraging the private sector to participate at a higher level than is currently the case.

Bode: My fears are that the far-right Republicans will get what they want and remove the stabilizing effect that the government plays in housing. Specifically, Rep. Jeb Hensarling has called for the elimination of HUD and wants to do away with Freddie Mac and Fannie Mae. MI premiums are the least of my worries with the Trump administration.

Story: In a perfect world, HUD would be agnostic to political winds, given its mission statement of providing strong, sustainable, inclusive communities and quality affordable homes for all. Sadly, this is not the case, and politics often drive the agenda for HUD and for providing homeownership in the U.S. We hope the new Congress will look past partisan agendas and understand the health and soundness of the MMI Fund and act accordingly with premium reductions.

Q: Considering the government-sponsored enterprises' (GSEs) low down payment programs, should the FHA be seeking to increase its footprint in the mortgage market? In your opinion, does it need to return to its core role of helping the underserved? If so, how should it go about doing that in this current market?

Pickel: I think the FHA is doing well serving its constituents today and should not be seeking to increase its role. If anything, we need to increase the role of private capital in the mortgage market to a far greater degree than we are seeing today.

Badciong: The FHA program as it is currently structured is meeting its core role. It is balanced and positioned to support today's housing market, the future housing market and the underserved, for whom it is intended to help. Reflective of this is its growing use by lenders and the strength of the MMI Fund, which is healthy, alive and growing. For these reasons, we do not think it needs to be expanded.

Canter: I think HUD should always be looking for ways to help the underserved markets through education, affordable housing initiatives, down payment assistance programs and even grants if funds are available. However, I don't think HUD should get sidetracked from its mission and try to increase its footprint to compete with the GSEs or private markets that exist in our space. HUD's mission statement is "to create strong, sustainable, inclusive communities and quality affordable homes for all." I think the key words are "strong" and "sustainable," and the FHA should remain focused on quality underwriting standards and guidelines that do their best to set up borrowers for success and not failure, no matter how far the other entities providing loans digress from their standards for obtaining a loan.

Dornay: It's healthy to encourage all of the GSEs, including the Federal Home Loan Bank System, to continue to improve and enhance their low- to moderate-income housing programs, while, at the same time, providing alternative financing through the FHA by maintaining an environment of competition. Low- to moderate-income families benefit from this environment, in which each institution is charged with providing and creating solutions. There is still a lot of work to be done on this front, and as each institution creates new solutions, it fosters more creative alternatives to how we can grow homeownership in the U.S. in a responsible manner.

Bode: If the last crisis taught us anything, it was that having solid underwriting guidelines keeps housing stable. The FHA stayed consistent and lost very little (other than market share that would not pay). The GSEs with No Income No Asset loans and subprime lending were the problem. As far as the FHA returning to its core role of helping the underserved goes, I think the FHA is doing a good job of getting lower down payment borrowers into housing. How should it go about doing that? Stay consistent with the tested guidelines.

Story: The FHA should always support its mission, and the private mortgage market collapse during the financial crisis proved the case for a strong and healthy FHA to step in and provide liquidity to the served and underserved mortgage markets. The uncertainty around the GSEs and their future role in the mortgage market will continue to provide opportunity for the FHA to achieve its goal. First-time home buyer premium reductions, eliminating the life of loan annual premiums and lowering the streamline refinance upfront premiums would help support its mission.