Myths and Facts about FHA

(November 2012)

FHA's single family mortgage insurance program was created in 1934 to provide access to safe, affordable mortgage financing for American families. FHA does not lend money to homeowners. Instead, FHA insures qualified loans made by private lending institutions. Since 1934 FHA has made the dream of homeownership a reality for millions of American families.

During the economic recession and housing downturn, FHA has been one of the only sources of mortgage finance available, and they have weathered the storm well. While banks, lending institutions and private mortgage insurers went bankrupt or collapsed, FHA has been there. During the worst economic crisis of our time, FHA provided access to homeownership to more than 2.8 million first time homebuyers in the last four years.

Today, FHA continues to provide insurance and pay claims. For the first time in its history the program does not currently have a full 30 years' worth of expected claim payments. But as our economy continues to improve, and housing prices continue to rise, so will FHA's financial health. FHA has been the shining light in our economic crisis, and we believe they will continue to be an integral force in our recovery.

MYTH: FHA IS BANKRUPT

FACT: FHA is not bankrupt. FHA's current cash reserves total $30.4 billion. FHA is said to be undercapitalized because their independent actuary estimates that they do not currently have sufficient reserves to pay projected claims over the next 30 years. FHA is one of the few entities required by law to hold reserves for claims over a 30 year period. By comparison, the Financial Accounting Standards Board only requires private financial institutions to hold reserves for losses over the next 12 months.

What many commentators do not mention is the fact that the FY12 Actuarial Review shows FHA will be fully capitalized again in FY2014, and will reach the desired 2% capital reserves ratio by 2017, which is above and beyond the required 30-years' worth of reserves. FHA also reports that "it is possible to return the MMI Fund capital ratio to a positive level within the year."

MYTH: FHA IS EXPERIENCING HIGH DEFAULTS AND FORECLOSURES

FACT: FHA, like every other holder of mortgage risk, has incurred financial losses as a result of overall market conditions that have led to increased foreclosures. An analysis of FHA data indicates FHA's problem is concentrated in older FHA loans that were significantly affected by the 33% decline in house prices since 2006. There has been widespread improvement in the performance of FHA loans since the market collapsed in 2008. But the legacy loans from 2007-2009 are placing a high burden on the fund. Seventy (70) billion dollars in projected future claims are attributable to that book of business.

It must be noted that the more recent book is performing very strongly; loans insured since 2010 are of high quality and are expected to continue to perform very well. Early payment defaults peaked in 2008 at 2.6% and are now at 0.3%. According to the most recent delinquency survey conducted by the Mortgage Bankers Association, "the total past due rate for FHA loans is now at its lowest level in over 10 years, and FHA's post-2010 books are performing much better than loans originated prior to 2010."

MYTH: FHA's MARKET SHARE IS TOO HIGH

FACT: FHA's market share is too high when viewed in the historical context. But it is performing the very role it was designed to do – filling the credit gap when private lenders flee the mortgage market. From FY1994 to FY 2002, FHA averaged about a 13% market share for loan originations. By FY 2006, FHA's share had declined to a low of 3.77%. FHA's market share peaked at 19.3% in 2010, is now returning to traditional levels and stands at 15.78% in FY2012. As housing markets stabilize and new mortgage regulations are finalized, private markets will once again have some certainty and the private market will return. This will allow FHA's market share to decline even further.

MYTH: FHA IS SQUEEZING OUT THE PRIVATE MARKET

FACT: FHA does not lend money. FHA insures loans made by the private market. FHA has been critical in filling the gap when the private market abandoned housing finance. Today, FHA does not insure loans over $729,750. If FHA was squeezing out the private market, we would expect that private lenders would be active in the market for mortgages over $729,750. Yet there is a significant lack of private credit in that market. Furthermore, FHA and the GSEs have greatly restricted their participation in the mortgage market for condominiums. Yet the private market hasn't thrived in this space either. With the private market unable or unwilling to return to housing markets, the role of FHA has never been more critical.

MYTH: FHA IS NOT SERVING ITS MISSION

FACT: FHA was created in 1934 during a similarly difficult time in housing finance markets when there was little private lending. Today, the agency is filling just the role it was designed for – to provide safe, affordable financing when the private market cannot or will not participate. In FY2011, over half of all African Americans who purchased a home and forty-nine percent of Hispanics did so with FHA financing. Moreover, 78% of FHA's borrowers were first time homebuyers.

MYTH: FHA BORROWERS ARE POOR RISKS

FACT: FHA borrowers today have credit scores at historically high levels. The average credit score for FHA purchase loans was 700 in FY12, compared to 696 in FY11. More than 30% of FHA borrowers in FY12 had credit scores above 720.

MYTH: FHA BORROWERS ARE HIGHLY SUBSIDIZED

FACT: FHA borrowers pay significant premiums to cover their mortgage insurance. Over the last 2 years, FHA has increased their premiums four times. In fact, today FHA's premiums – both the upfront and the annual – are higher than they have ever been. Today's premiums include a 1.75% upfront premium, and 1.25% in an annual premium, that is paid monthly. Furthermore, the FHA has also announced moving forward that they will increase the annual fee to 1.35%.