



# HOUSING FINANCE REFORM DEBATE: HOW CAN THE FHA MEET THE FUTURE NEEDS OF US HOUSING?

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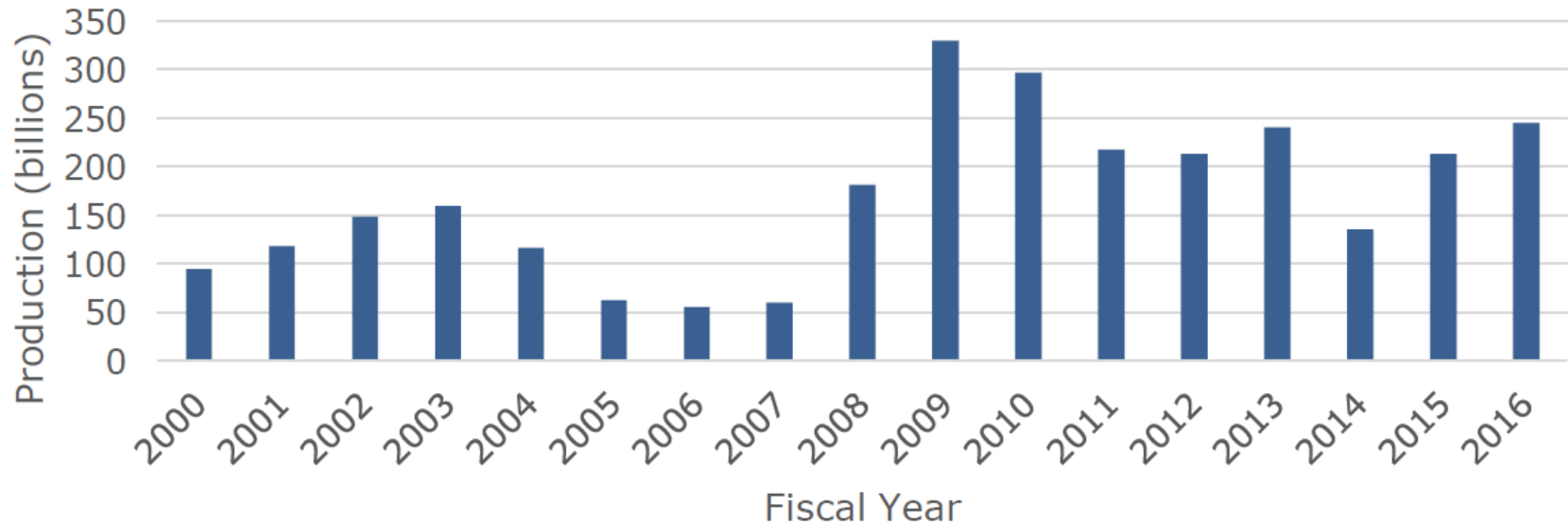
# Mission Critical: Retooling FHA to Meet America's Housing Needs

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Carol Galante  
January 9, 2018

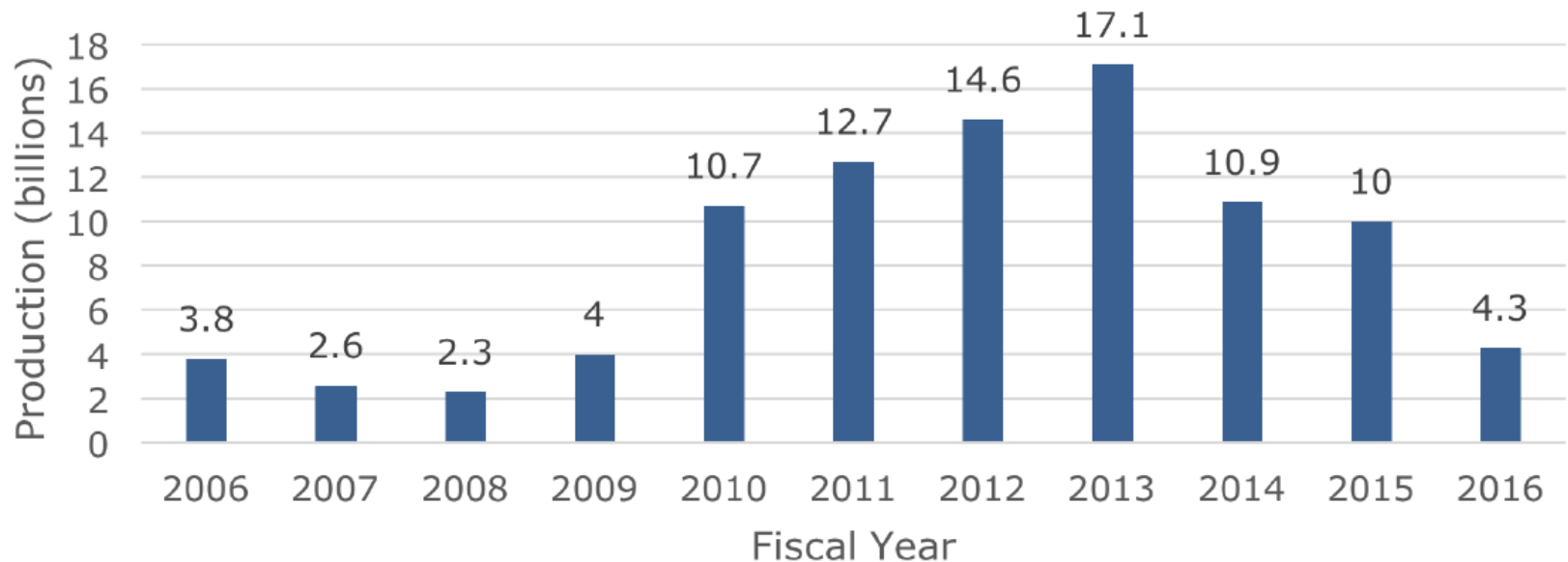
# FHA: An Important Component of the US Housing Finance System

## FHA Single-Family Forward Mortgage Endorsements



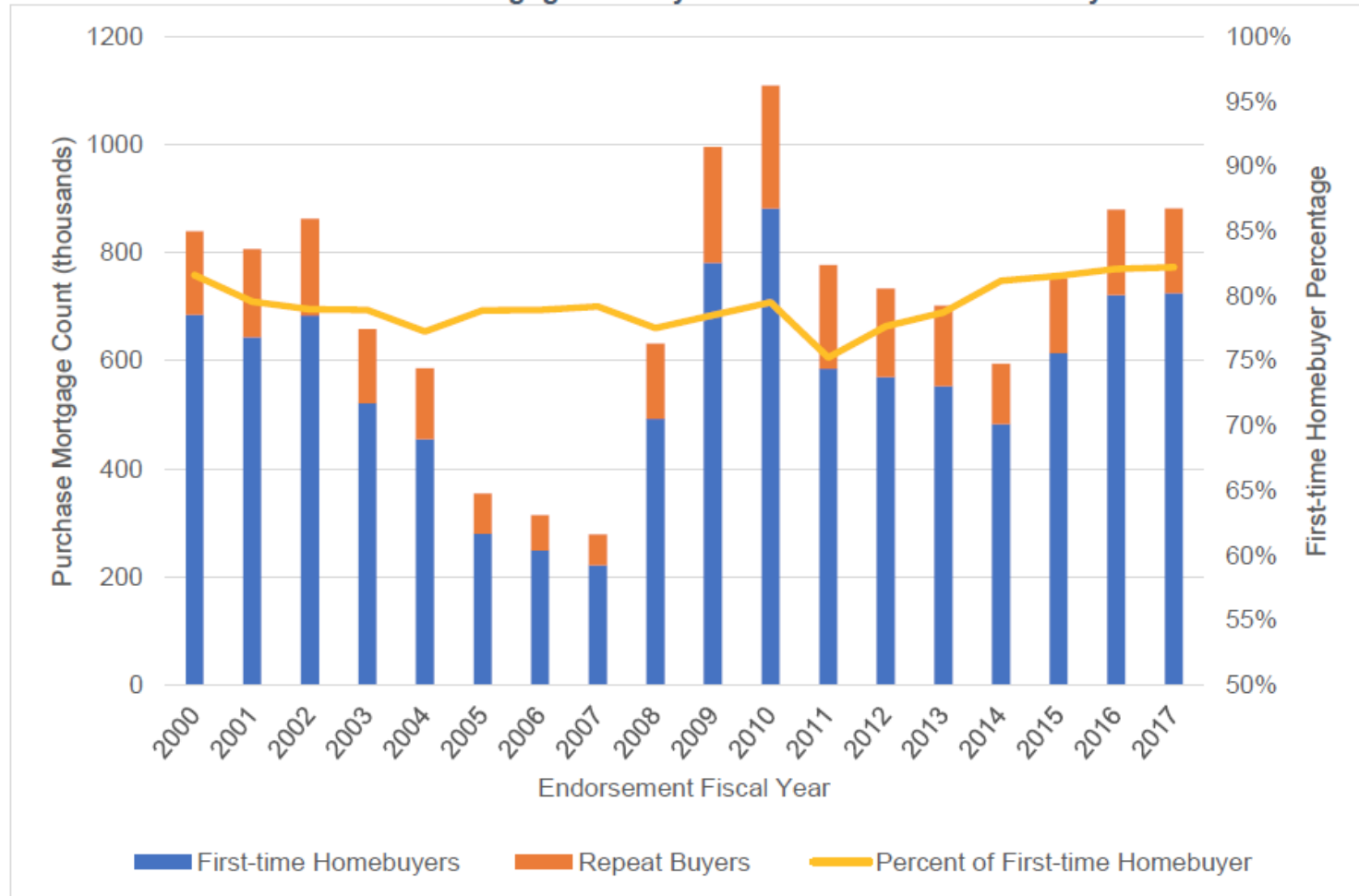
# FHA: An Important Component of the US Housing Finance System

## Multifamily Endorsements



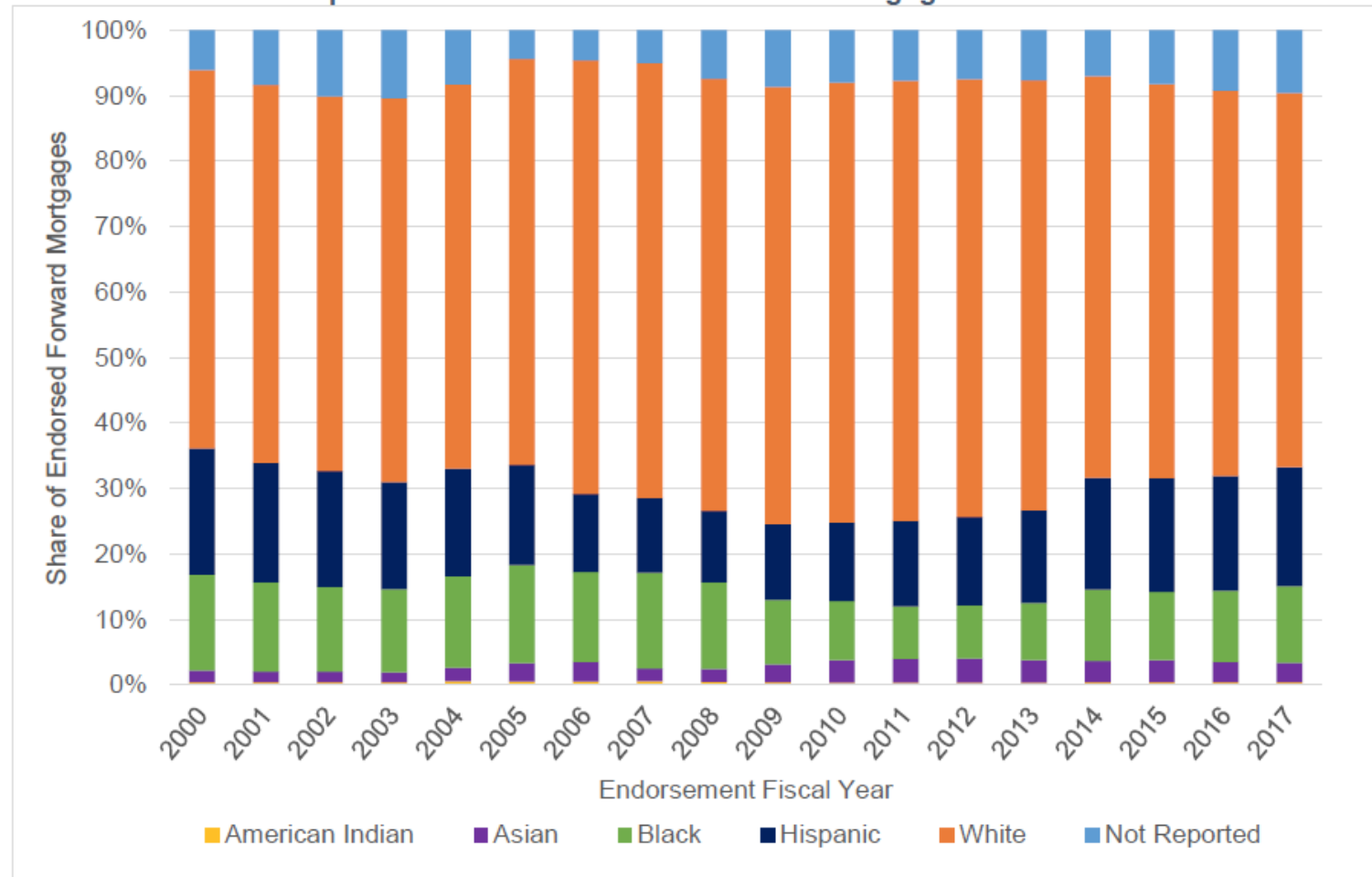
# Serving the Underserved

Exhibit I-3: Historical Purchase Mortgage Activity and FHA First-Time Homebuyer Share



# Serving the Underserved

Exhibit I-4: Racial Composition of FHA Forward Endorsed Mortgages



# Serving the Underserved

- 33.3% of FHA endorsements served minority borrowers in 2017
  - 18.2% Hispanic
  - 11.7% Black
  - 03.0% Asian
- In 2017, 37.7% of ALL minority borrowers using a mortgage to purchase a home did so with a mortgage backed by FHA

# Principles of Reform

- FHA's focus must remain on underserved populations while also continuing to serve a broad spectrum of lower-wealth homebuyers
  - Low down payments
  - Long-term fixed rate loans
  - Mortgage insurance premium pricing that averages pricing across the full range of credit risk
  - A 100 percent insurance guarantee backed by the full faith and credit of the United States Government
- FHA must continue to be available as a countercyclical force in periods of economic stress
- FHA must have the tools and resources to manage its risks while executing its role and mission in the housing finance system

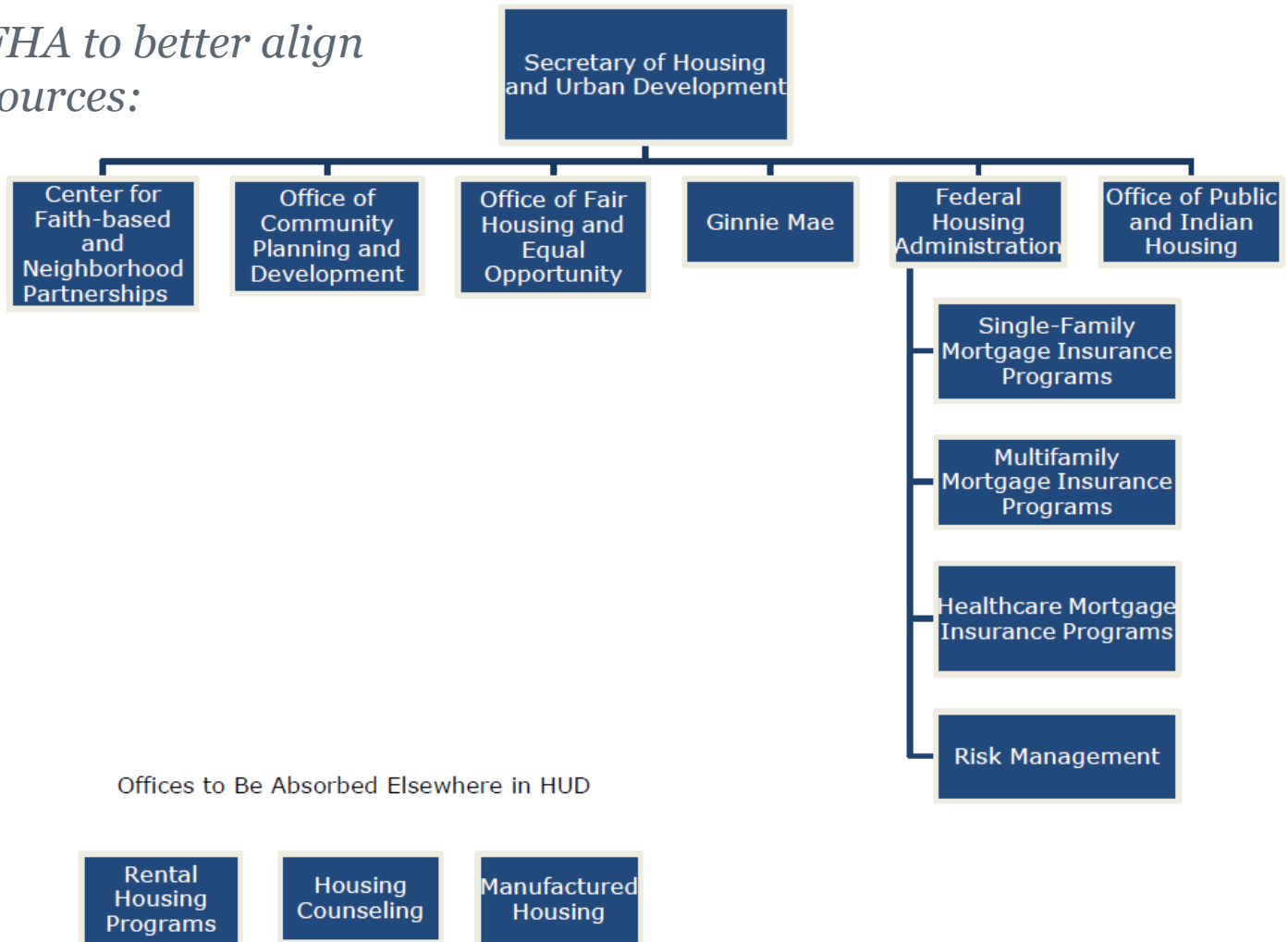


# Better Target FHA's Programs

- Maximum Loan Limits
  - FHA's maximum loan limit should be set at 100% of the median house price for a particular geographic region rather than the current 115%
- Loan Limit Methodology
  - The use of smaller population-based geographic sub-regions (e.g. zip codes or census tracts) should be employed to better ensure that FHA's loan limits accord with actual market values in a given area
- Restrict Product Offerings
  - Only purchase mortgages and refinances of existing FHA-insured mortgages (in normal times)

# Structural Changes

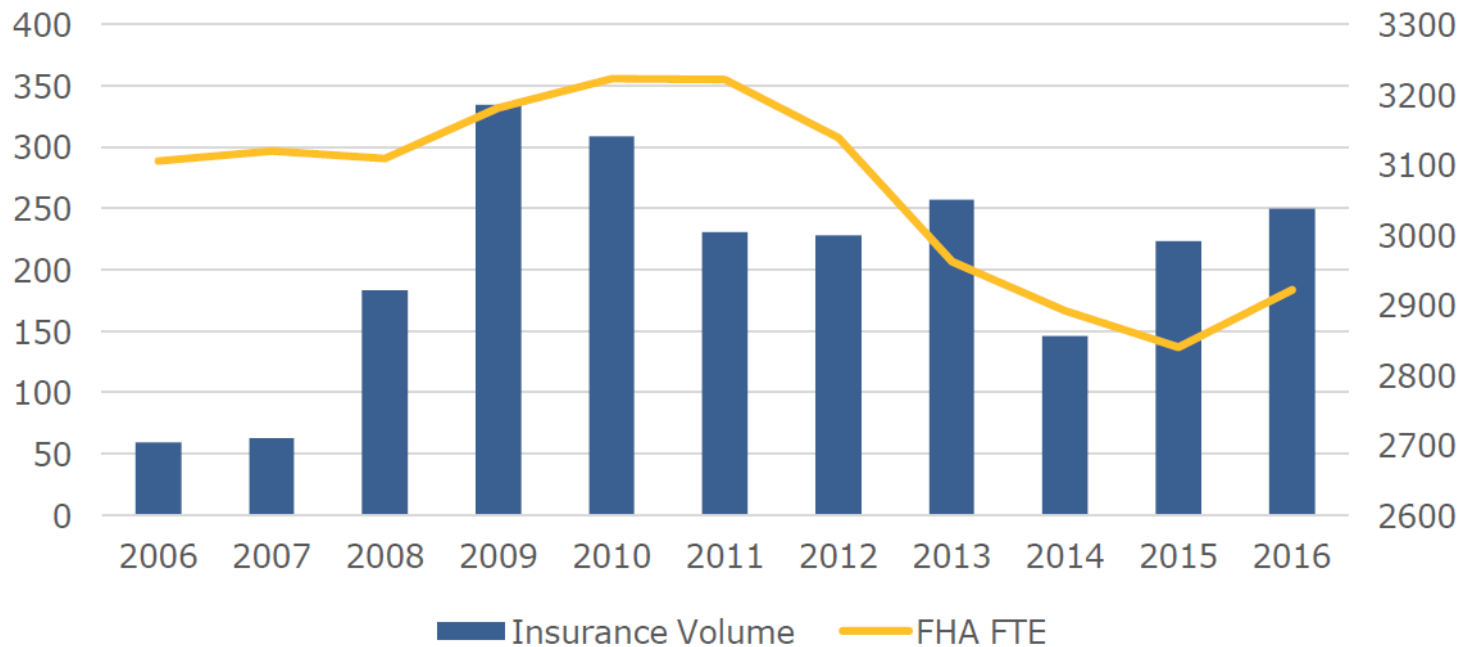
*Restructure FHA to better align focus and resources:*



# Budget Authority

*Provide FHA a baseline appropriation, supplemented by retention of a portion of its insurance revenues.*

Comparison of Insurance Volume and Staffing Levels at FHA 2006-2016



# Capital Reserves



- Establish a new capital reserve standard that better accounts for tail risk
- Separate reserves for forward and reverse mortgage programs, and remove HECM from capital reserve calculation
- Provide FHA greater flexibility in loss mitigation strategies and use of operating capital to minimize losses

# Management of FHA Operations

Minimize red tape by permitting FHA to better exercise flexibilities afforded to government corporations

- Allow FHA to establish its pay scales with higher salaries for key positions
- Greater flexibility with regard to procurement and disposal of property

# Emergency Powers Authority

Grant FHA emergency powers under specified circumstances, which allow it to temporarily:

- Suspend or modify FHA insurance programs
- Receive an exemption from the Federal Acquisition Regulation (FAR), enabling it to more easily enter into contracts to expand consulting, research, and operational capabilities, and/or mitigate risk

# Non-Legislative Policy Changes

- Provide certainty and transparency regarding lender certifications and liability
- Publish permanent policy governing mortgages for condominiums
- Update policies on deed restricted Affordable Projects
- Streamline and update loss mitigation and property disposition policies and procedures

# FHA as Leader in SF Innovation

- A retooled FHA should lead in innovation and product testing to establish new means of safely and effectively addressing emerging affordable housing needs and opportunities, including:
  - Lease-purchase options
  - Dedicated single family affordable products, including for shared equity and long term rental
- Improve customer service via introduction of new technology that better interfaces with standard industry technology systems



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*Thank you!*

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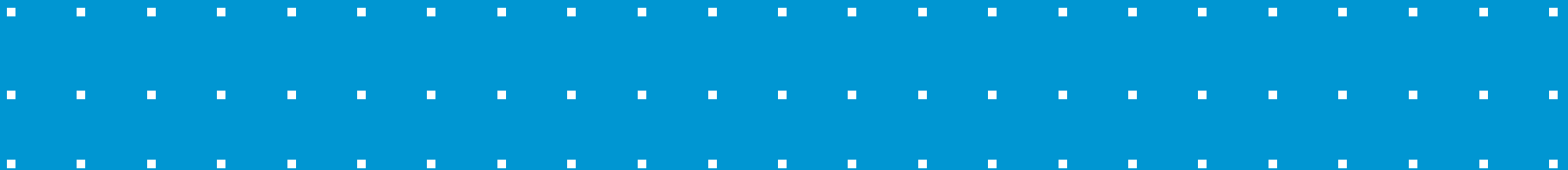
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# FHA: Where We are Today

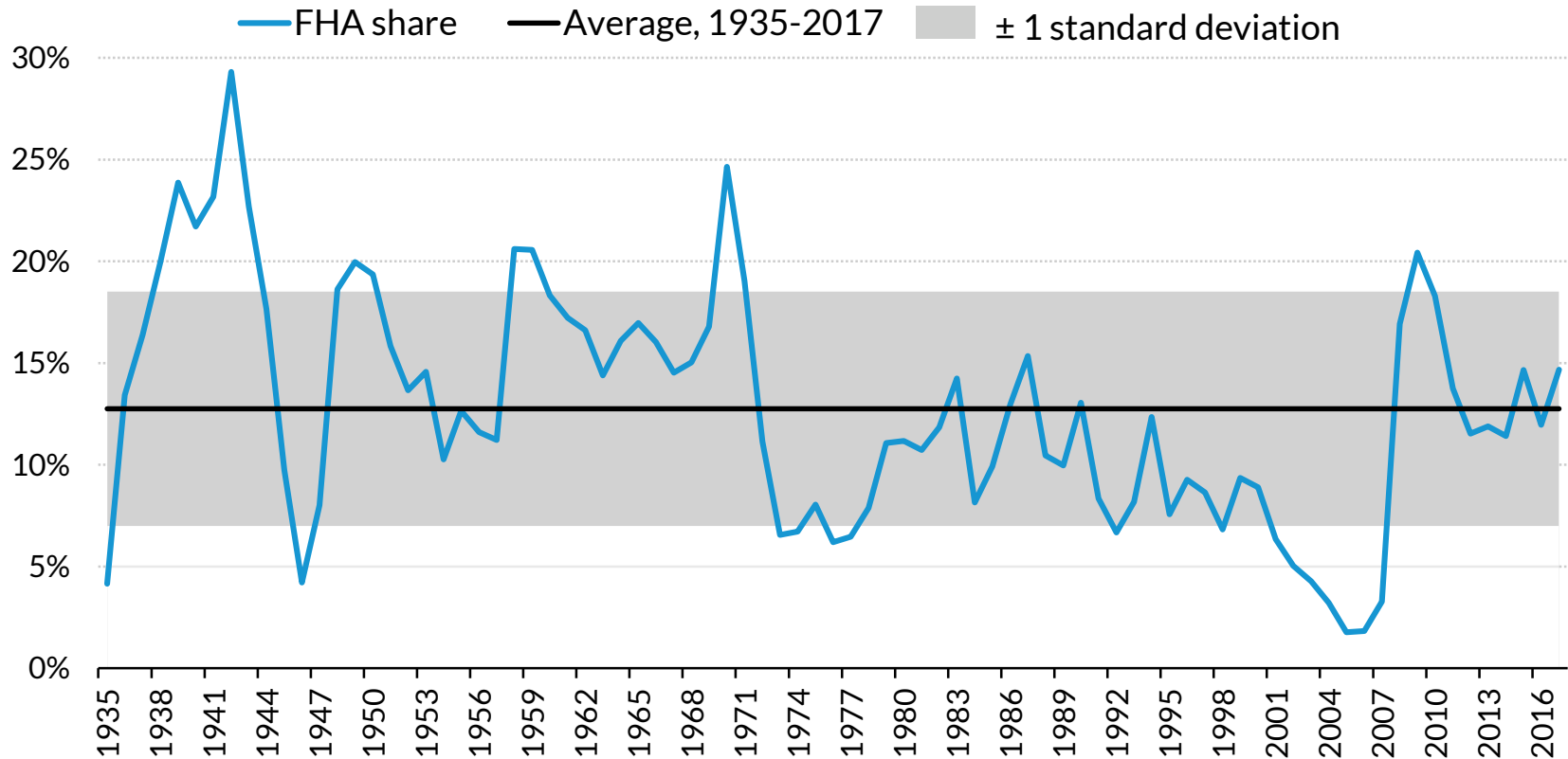
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January 9, 2018



# FHA Share of Single-Family Originations, 1935-2017

- FHA's share has averaged 12.8 percent over the entire period.
- FHA has played an important countercyclical role.

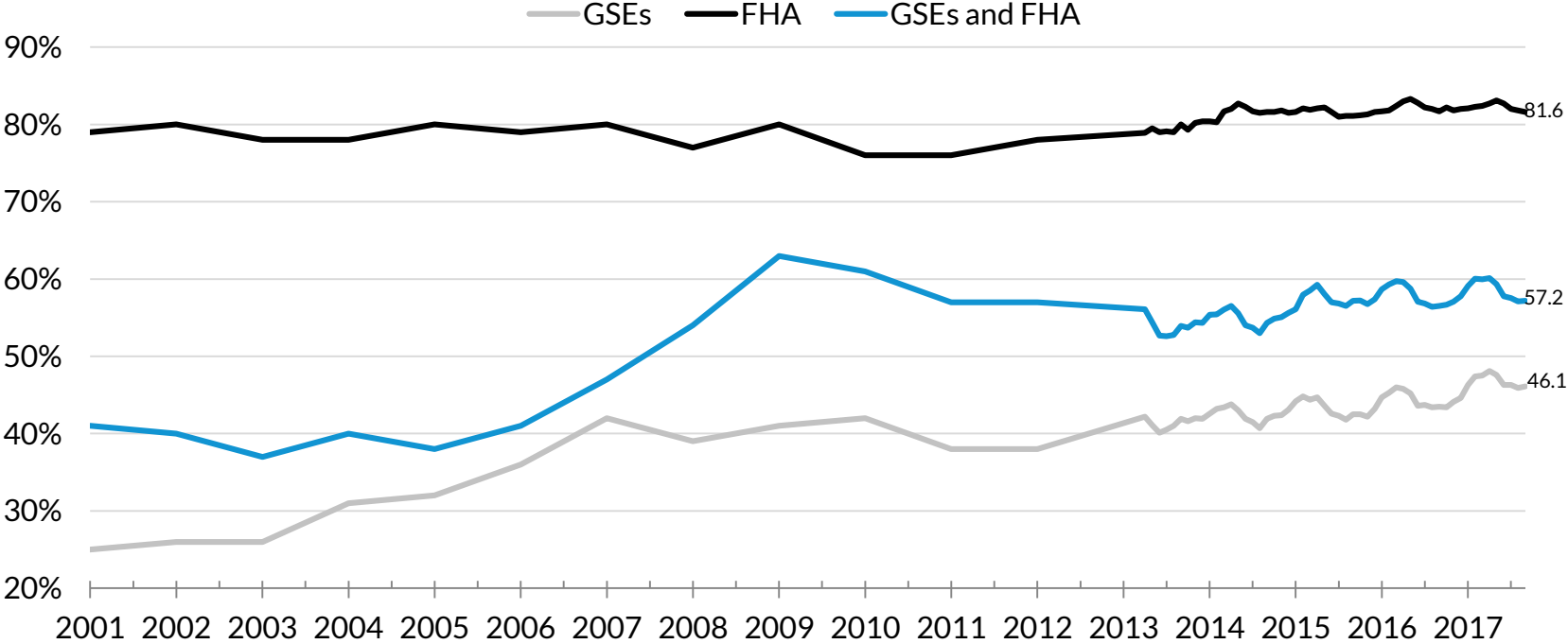


Note: 2016 and 2017 share based on estimates.

Source: Inside Mortgage Finance, Mortgage Bankers Association, CoreLogic, and Urban Institute.

# FHA disproportionately serves first time homebuyers

### First-Time Homebuyer Share



Sources: eMBS, Federal Housing Administration (FHA) and Urban Institute.  
Note: All series measure the first-time homebuyer share of purchase loans for principal residences.

# FHA borrowers have weaker credit characteristics

## Comparison of First-Time and Repeat Homebuyers, GSE and FHA Originations

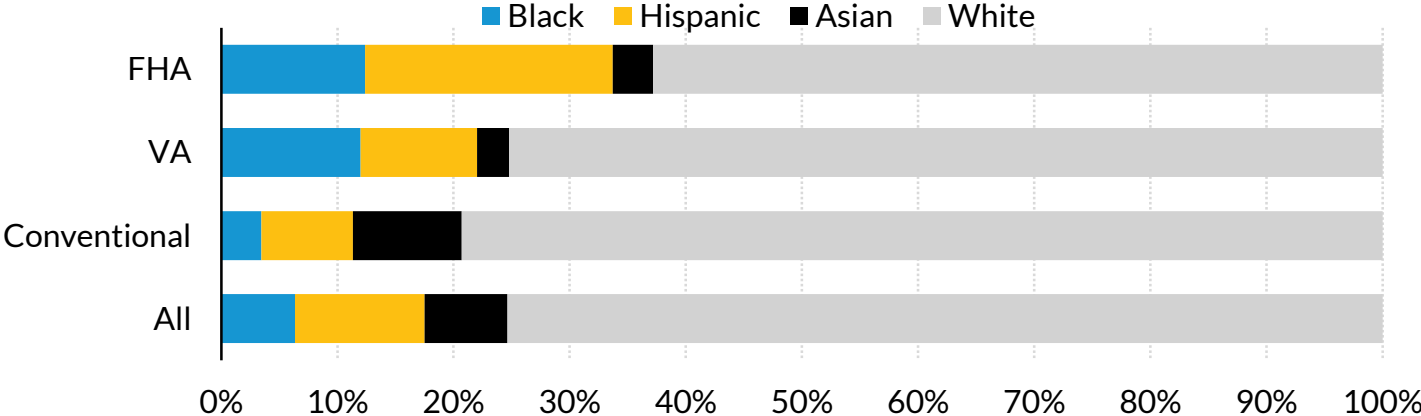
Characteristics	GSEs		FHA	
	First-time	Repeat	First-time	Repeat
Loan Amount (\$)	226,878	250,283	201,996	225,734
Credit Score	738.4	753.7	675.0	681.5
LTV (%)	87.2	79.1	95.5	94.1
DTI (%)	35.1	35.7	42.2	43.4
Loan Rate (%)	4.15	4.02	4.18	4.10

Source: eMBS and Urban Institute.

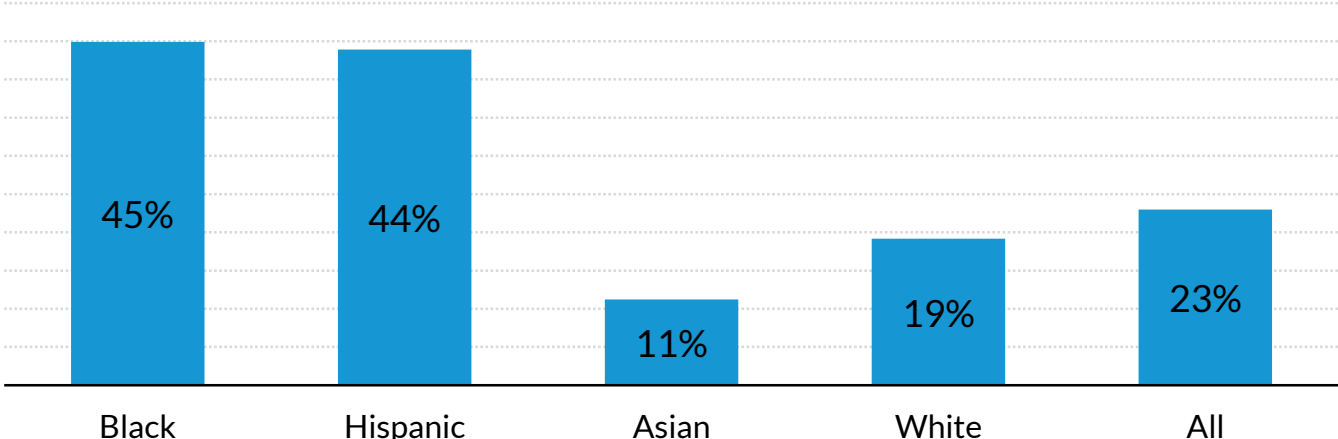
Note: Based on owner-occupied purchase mortgages originated in September 2017.

# FHA disproportionately serves minorities

Percent of purchase loans by channel and race/ethnicity



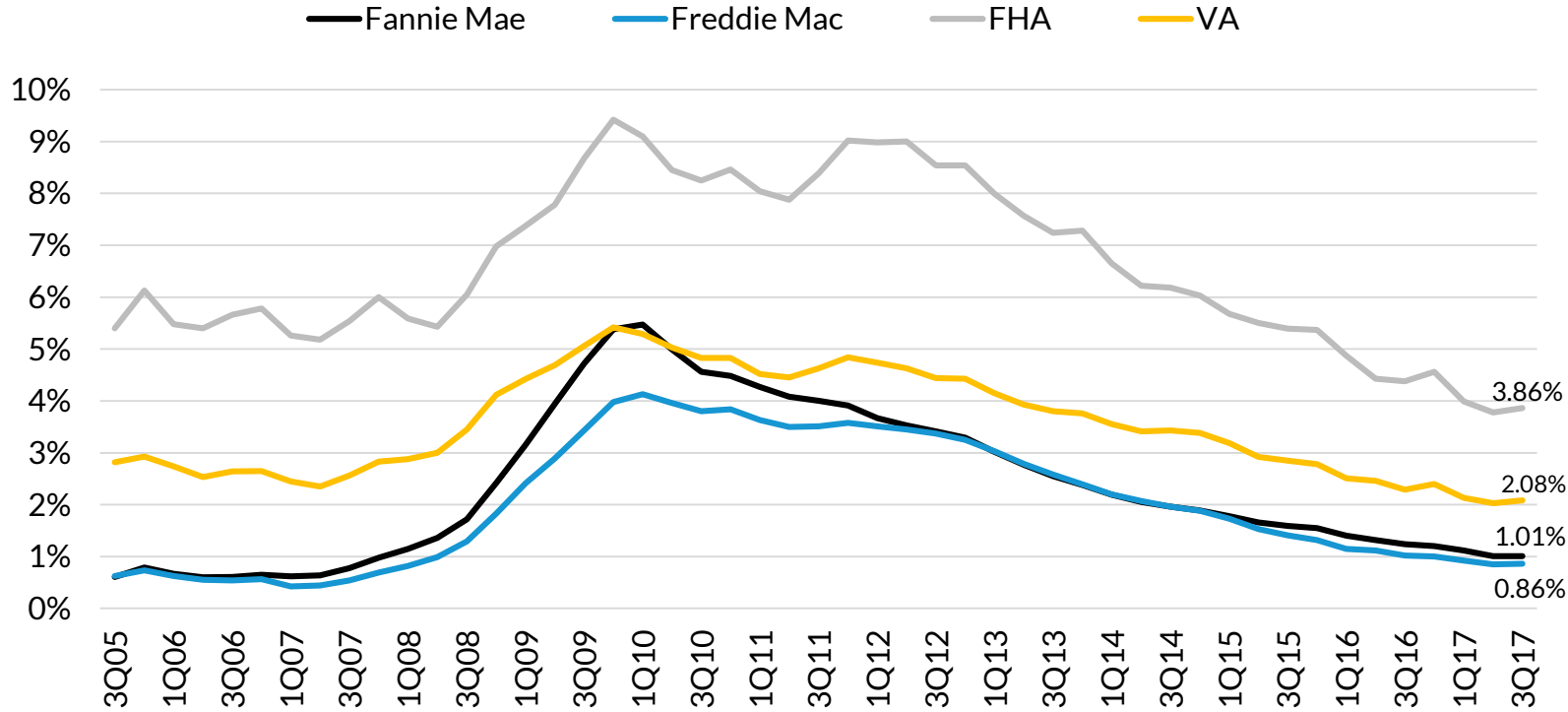
Percent of purchase loans that are FHA-insured by race/ethnicity



Source: 2016 HMDA and Urban Institute.

# FHA Delinquency Rates vs. Conventional and VA

## Serious Delinquency Rates: Single-Family Loans

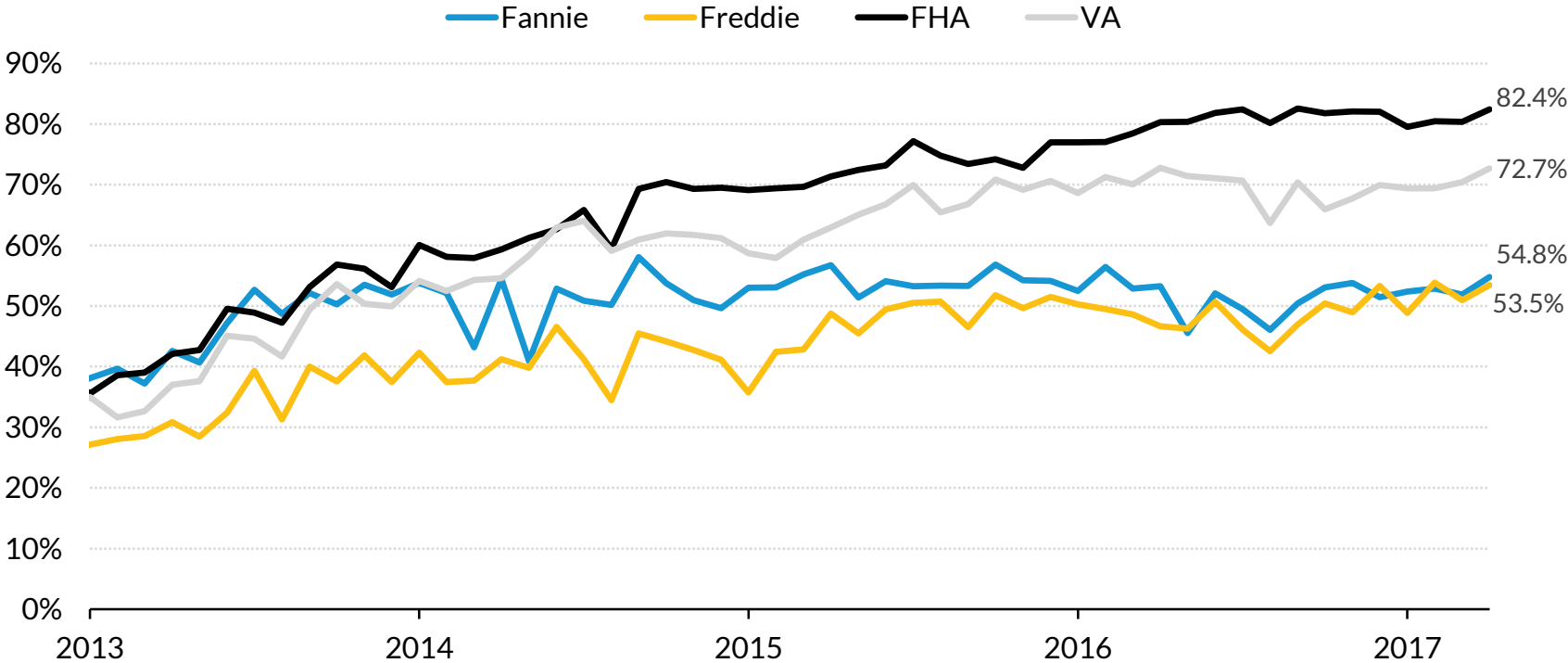


Source: Fannie Mae, Freddie Mac, MBA Delinquency Survey and Urban Institute.  
 Note: Serious delinquency is defined as 90 days or more past due or in the foreclosure process. Data as of Q3 2017.



# FHA origination is dominated by non-banks

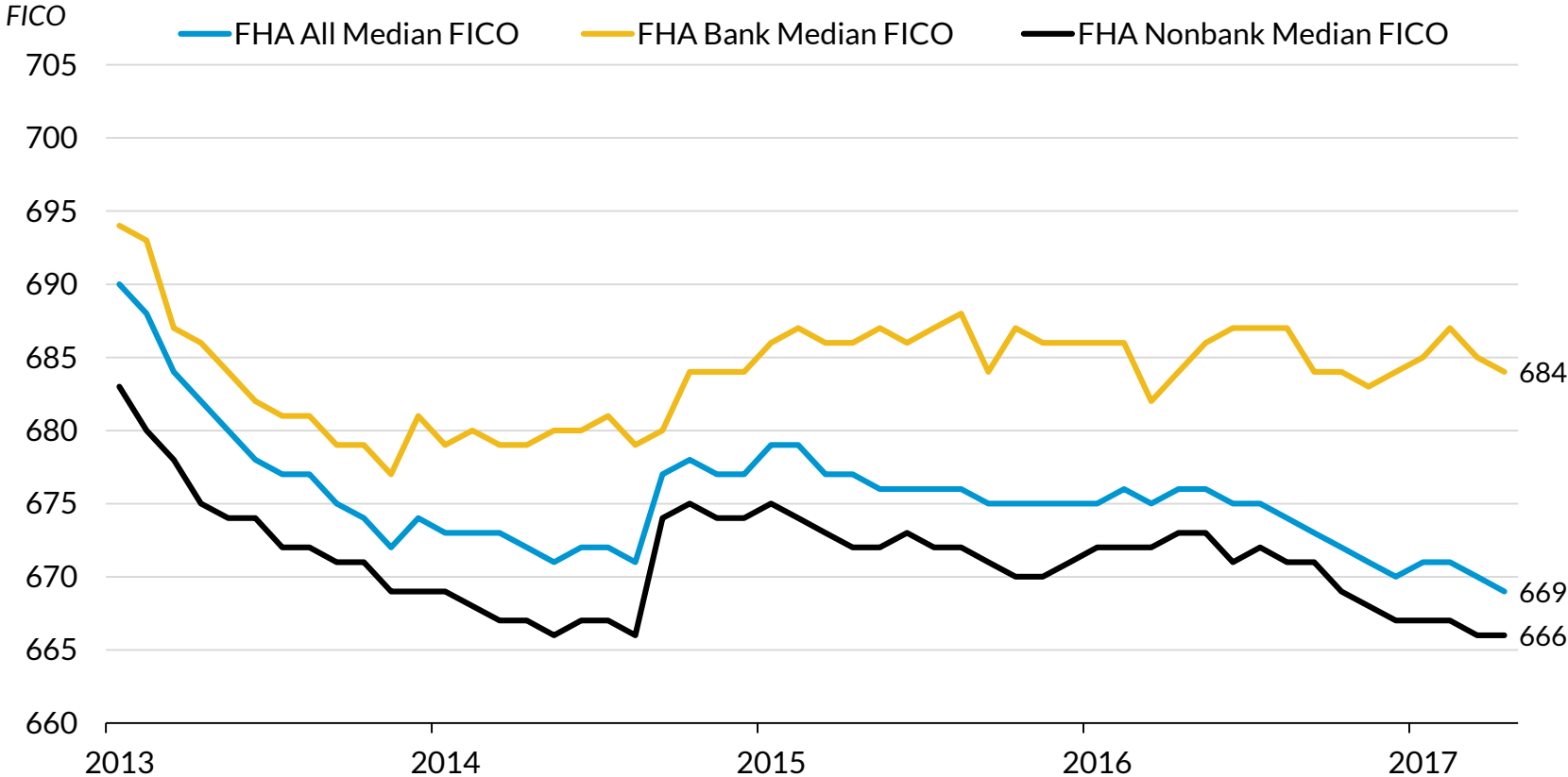
## Non-bank Origination Share



Source: eMBS and Urban Institute.

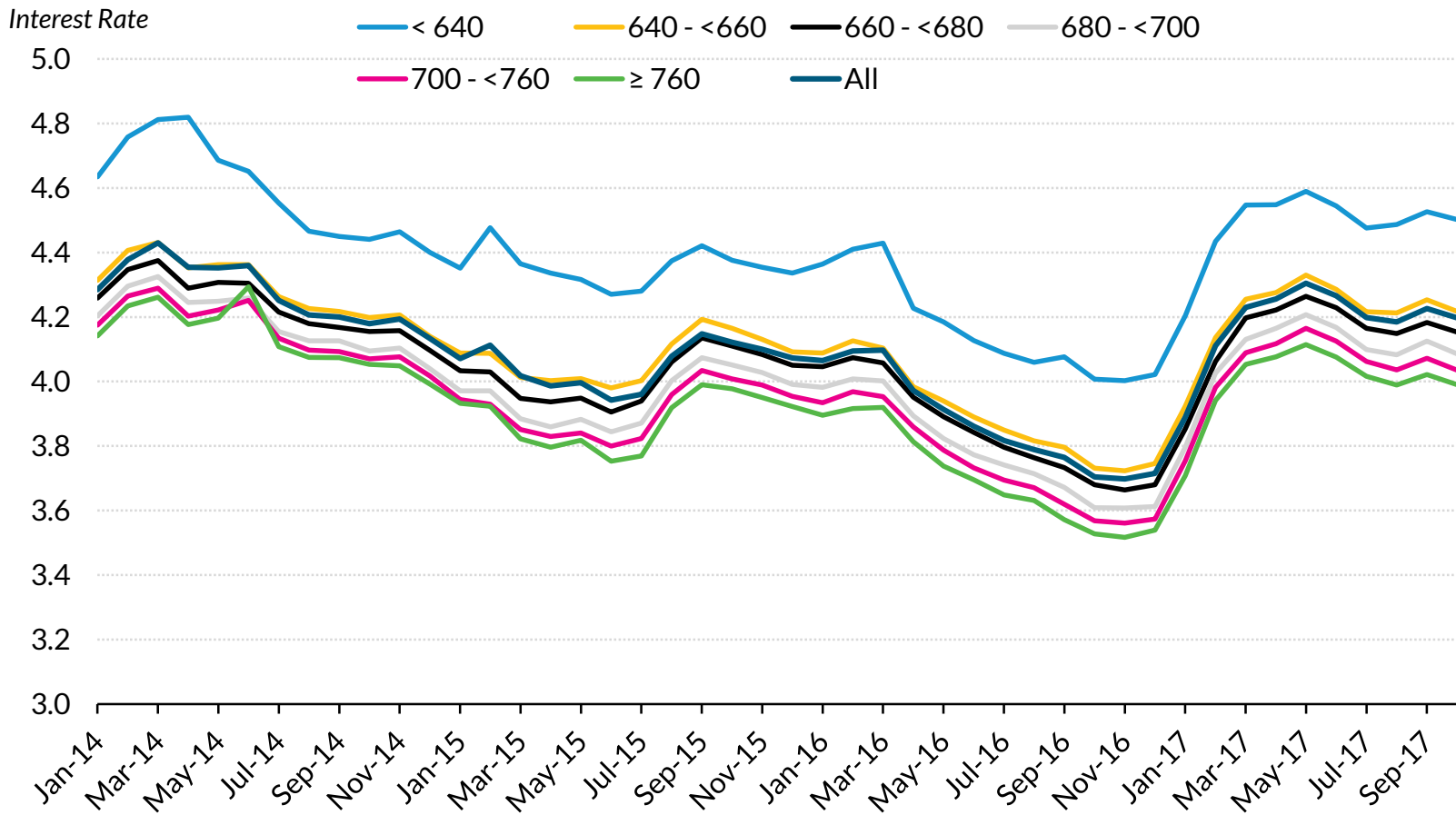
# Nonbank FHA originators have a wider credit box

## FHA FICO Scores by Originator Type



Source: eMBS and Urban Institute.

# Originators charge more for weaker borrowers; even though FHA does not do risk-based pricing



Source: eMBS and Urban Institute.

# Two steps to strengthen today's FHA

## 1. Remove uncertainty created by the False Claims Act.

There are two ways to do this:

- Improve the certification
- Fully implement the defect taxonomy(FHA's Single Family Housing Loan Quality Assessment Methodology)

## 2. Reduce the costs and complexity of servicing troubled loans

- Allow for a unified timeline
- Reform the conveyance process
- Expand the toolkit to allow for successful modifications in a rising rate environment

# False Claims Act Settlements and Litigation

Firm	Settlement Date	Amount
Citi	Feb-12	\$158.3 million
Flagstar Bank	Feb-12	\$132.8 million
Bank of America	February 2012 (NMS), August 2014 (broader settlement)	\$1 bil (NMS), \$1.85 bil (broader settlement)
DB/Mortgage IT	May-12	\$202.3 million
Chase	Feb-14	\$614 million
US Bank	Jun-14	\$200 million
SunTrust	Sep-14	\$418 million
MetLife	Feb-15	\$123.5 million
First Horizon/First Tennessee	Jun-15	\$212.5 million
Walter Investment Management Corp	Sep-15	\$29.6 million
Franklin American	Dec-15	\$70 million
Wells Fargo	Apr-16	\$1.2 billion
Freedom Mortgage	Apr-16	\$113 million
M&T Bank	May-16	\$64 million
Regions Bank,	Oct-16	\$52.4 million
Branch Banking and Trust (BB&T)	Oct-16	\$83 million
Primary Residential Mortgage	Oct-16	\$5.0 million
Security National Mortgage Co.	Oct-16	\$4.25 million
United Shore Financial Services	Dec-16	\$48 million
PHH Mortgage	Aug-17	\$75 million
Allied Home Mortgage Capital/Allied Home Mortgage Corporation	Sep-17	\$296 million
IberiaBank (LA)	Dec-17	\$11.7 million
<b>Litigation in Process</b>		
Quicken Loans	--	--
Guild Mortgage	--	--

Source: Urban Institute, various press releases from the U.S. Department of Justice Office of Public Affairs, and other press reports

# Urban Institute's Mortgage Servicing Collaborative

Mortgage Servicing Collaborative: The purpose of the collaborative is to bring the work of developing, analyzing and making recommendation for reforms that seek to improve access to credit for consumers and address lender reluctance to originate and service mortgages.

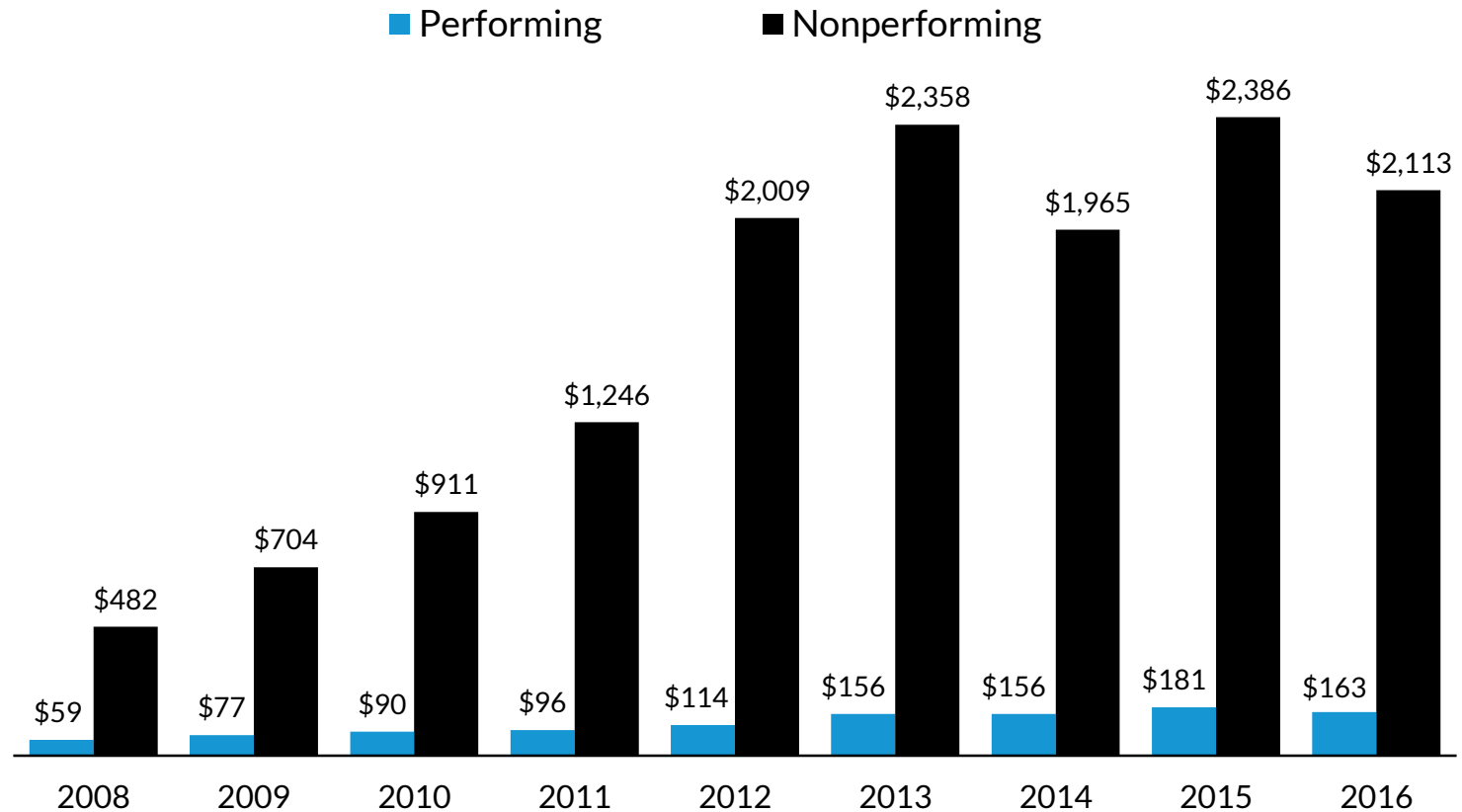
Collaborative Members: National Servicers, depositories and non-banks, community banks, credit unions, consumer and civil rights organizations, academics, specialty servicers/sub-servicers, trade associations, technology providers

First Set of Issues Tackled by MSC:

- Improvements in FHA Servicing
- Government modifications in a rising rate environment

# Cost of Servicing

- Servicing nonperforming loans is much more expensive than servicing performing loans.
- FHA servicing is still more expensive; servicing FHA nonperforming loans is 3 times as expensive as servicing GSE nonperforming loans.



Source: Mortgage Bankers Association Servicing Operations and Forum and Urban Institute.

# Recommendations to Improve FHA Servicing

## Unified Timelines

- FHA currently has three timelines: one from first missed payment to first legal action date (the date foreclosure must be initiated), one from the first legal action date to the foreclosure auction and a third from the foreclosure auction to conveyance.
- There are interest curtailment penalties from the date of the missed deadline to conveyance; the penalties do not reflect the number of days of delay.
- There should be one unified timeline, as is the case for VA and GSE loans; this would provide for more flexibility in the loss mitigation process.

## FHA conveyance

- The FHA conveyance process does not have a counterpart in any other entity. For both GSE and VA loans, foreclosure is done in the name of the agency. On FHA loans, foreclosure is done in the name of the lender; the lender must then convey the property to FHA.
- This process takes a year, is very costly to all (FHA, lenders, and most important, to communities) and produces sub-optimal outcomes. To optimize the outcome, some properties should be improved before sale, others should not.
- In the short term, FHA should address the costly conveyance process by increasing the flexibility around conveyance alternatives (short sales, third party sales, foreclosure sales); in particular, the Claim Without Conveyance of Title Program could be improved.
- In the longer term, the conveyance issue should be improved by building a direct conveyance capability within HUD, or using the GSE REO disposition infrastructure.



# Comparison of current FHA, USDA, VA, and GSE Modification Toolkits

	FHA mod.	USDA mod.	VA mod.	GSE Flex Mod
Rate reduction	No more than PMMS + 25 bps	No more than original rate for traditional mods.; no more than PMMS + 50 bps for special mods.	Set rate to PMMS + 50 bps; rate increase capped at 1%	Set rate to lower of PMMS or original rate
Term extension	Extend to 360 months	Extend to 360 months for traditional or 480 months for special	Extend to 360 months	Extend to 480 months
Mortgage balance reduction	Partial claim of up to 30% of defaulted UPB	MRA of up to 30% of defaulted UPB (once over life of loan)	No partial claim or MRA; principal forbearance at servicer expense	Forbear principal to 100% LTV, subject to cap of 30% of UPB or 80% MTMLTV <sup>a</sup>
Postmodification pooling	Re-pool at market rate; below-market-rate mods. at servicer expense	Re-pool at market rate; below-market-rate traditional mods. at servicer expense	Re-pool at market rate; below-market-rate mods. at servicer expense	Held in GSE portfolios; below-market-rate mods. at GSE expense

**Note:** : bps = basis points; FHA = Federal Housing Administration; GSE = government-sponsored enterprise; LTV = loan-to-value ratio; MRA = Mortgage Recovery Advance; PMMS = Freddie Mac Primary Mortgage Market Survey; UPB = unpaid principal balance; USDA = US Department of Agriculture; VA = US Department of Veterans Affairs.

<sup>a</sup> MTMLTV, or mark-to-market loan-to-value ratio, is the unpaid principal balance of a mortgage divided by the current property value. It is a measure of how much equity (or negative equity) a borrower has in the home.

Source: Urban Institute

# Recommendations to Improve Government Modifications in a Rising Rate Environment

The government modification toolkit is much more limited than the GSE toolkit.

## Government Modification Levers:

- reset to a market rate of interest (GSE loans allow for the rate to be set to the lower of PMMS or the original rate)
- term extension (to 360 months, GSEs allow 480 months)
- partial claim (up to 30% of UBP; VA has no mechanism to do partial claims at all)

## Solutions:

- (1) Partial claim with recast for FHA and USDA (i.e. modify mortgage within the pool to eliminate re-pooling.
- (2) Principal forbearance for FHA, USDA and VA)
- (3) Extend mortgage to 40 years
- (4) Create a balance sheet for warehousing modified, unsecuritized loans.

Only the first two of these is viable in the near term.



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