

MORTGAGE LENDING UPDATE

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FHA Tightening

As if first time homebuyers needed any further impetus (above and beyond the soon to be expiring \$8,000 federal tax credit) to get it in gear, we now hear of FHA's new plans. Below is information contained in an excellent article from Tami Luhby, senior writer for cnmnews.com.

"It's soon going to be harder to get an FHA government-backed mortgage. Looking to shore up its weakening finances, the Federal Housing Administration announced stricter lending standards Wednesday.

The agency, which insured nearly a third of new mortgages in 2009, will increase the premium it charges for its mortgage insurance and require those with weaker credit scores to come up with larger downpayments. The FHA will also reduce the amount of money a seller can provide a homebuyer for closing costs, as well as tighten its enforcement of lenders.

"Striking the right balance between managing the FHA's risk, continuing to provide access to underserved communities, and supporting the nation's economic recovery is critically important," FHA Commissioner David Stevens said in a statement. "Importantly, FHA will remain the largest source of home purchase financing for underserved communities."

FHA loans have skyrocketed in popularity during the mortgage crisis since the agency backstops banks if borrowers stop paying. But housing experts are growing increasingly concerned about the agency's ability to handle rising numbers of defaults. In November, the agency reported that its reserve fund has dropped to 0.53% of its insurance guarantees, well below the 2% ratio mandated by Congress and the 3% ratio it had last fall. The fund covers losses on the mortgages the agency insures.

Federal housing officials, who took several steps to shore up the agency's finances last year, promised to do more at a congressional hearing in December. The new announcement is the latest set of changes to FHA policies. FHA is making these changes in order to bring its reserve fund up back up to the 2% ratio, Stevens said in a conference call with reporters. However, the agency also wants to make sure that the new rules don't disrupt the housing market and don't hurt FHA's ability to assist the underserved.

The agency will increase its up-front mortgage insurance premium to 2.25%, from 1.75%. It will also ask Congress for the right to hike its ongoing premium, currently as much as .55% monthly. Once it gets permission, the agency will shift some of the up-front premium to the ongoing charge, which will have less of an impact on borrowers. Raising the premium is the best way to add to the reserve fund, Stevens said.

The FHA will also require borrowers to have at least a credit score of 580 to qualify for the agency's 3.5% downpayment program. Those with lower scores will have to pay at least 10%. (David here. This is all sunshine and light about FHA's wishful thinking concerning a 580 credit score. Mortgage investors -- those that actually lend the money -- have not been allowing credit scores under 620 for any mortgage loan program, including FHA, for quite some time now. The current required minimum 620 score may change at some point in the distant future, but probably not anytime soon.)

The new policy also will reduce the amount of money sellers can provide to homebuyers at closing to 3%, down from 6%, of the home's price. That change will bring the agency in line with industry standards and remove the incentive to inflate appraisals. (This is REALLY bad news, because it means that homebuyers will have to come up with more money to close.)

Finally, officials plan to clamp down on lenders offering FHA mortgages. The agency will more closely monitor their performance, as well as seek legislative authority to require mortgage firms to assume liability for all loans they originate and underwrite. It will also publicly report lender performance data.

One thing the agency did not do is to broadly increase the downpayment requirement. Many industry observers said such a step is necessary to reduce FHA loans' high delinquency rates. Borrowers with little equity in their homes are more likely to default or walk away. The agency has seen a spike in delinquencies amid the mortgage meltdown. Some 14.36% of FHA loans were past due in the third quarter, according to the Mortgage Bankers Association. This compares to 9.64% of all loans.

"They are not addressing the fundamental issue -- that FHA loans are too risky," said real estate finance consultant Edward Pinto, former chief credit officer for Fannie Mae in the late 1980s. Borrowers "need more skin in the game." FHA did not increase minimum downpayments more broadly because its borrowers with credit scores above 580 were generally timely with their payments.

As banks have clamped down on mortgage lending, the FHA program has emerged as one of the few ways people can buy a home. Banks are more willing to make FHA loans because they come with a federal guarantee to cover losses if the borrower defaults. And borrowers can more easily qualify for FHA loans because they only need 3.5% down and can have lower credit scores. (Not really.) As a result, demand for FHA loans has exploded. The agency guaranteed more than \$360 billion in single-family mortgages in fiscal 2009, which ended Sept. 30, more than four times the volume in 2007.

The agency insured about 30% of home purchases and 20% of refinanced mortgages in 2009. Nearly 50% of first-time homebuyers go through the agency."

David Griffin has been financing homes in Macon, Warner Robins and all of Middle Georgia since 1983 and is a member of the Mortgage Bankers Association of Georgia, mbag.org. For an archive of past articles visit mbag.org/ML_Update.htm. (1-21-10)