



# FHA and the need to strike the right balance for taxpayers

Traditionally important to serving underserved markets, FHA poses too much risk to taxpayers

By Rohit Gupta

- The recent decision by the Federal Housing Administration (FHA) to lower annual mortgage insurance premiums has generated an important discussion in Washington about the roles of government and private capital in supporting homeownership, while at the same time protecting taxpayers. This is especially true when it comes to the market for first time homebuyers and other creditworthy borrowers who are unable to make prohibitively large down payments.

Potential homeowners without the ability to make a 20 percent down payment currently have two options for the mortgage insurance necessary to obtain a mortgage: either from the government-backed FHA program, or from private mortgage insurance (MI). To the average consumer, the options may sound very similar, but from a public policy perspective, they are in fact quite different, especially when it comes to the impact on taxpayers.

First, FHA covers virtually 100 percent of losses if a loan defaults, which may provide less incentive to ensure that loans are underwritten and serviced in a prudent and sustainable manner. By contrast, MI covers first losses down to a stated coverage percentage, creating a strong incentive for prudent underwriting and good servicing.

In the wake of the financial crisis, the FHA insurance fund required \$1.7 billion from U.S. taxpayers due to a capital shortfall. In contrast, MI private capital covered over \$44 billion in losses on loans sold to the GSEs since they entered conservatorship, losses that otherwise would have been shouldered by taxpayers.



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Finally, FHA capital reserve standards are lower than MI. FHA is required to be at a minimum capital ratio of 2 percent of risk insured but is currently at only a 0.41 percent capital ratio, one fifth of the two percent statutory minimum. MIs are required to be at a minimum risk to capital ratio of 4 percent, and all MIs are reporting risk to capital ratios at or below 18:1. MIs will be required to meet even higher capital standards under revised GSE Private Mortgage Insurer Eligibility Requirements (PMIERs) that are due to be finalized later this year.

The recent decision to lower FHA premiums is a good illustration of the potential for unintended consequences when it comes to striking the right balance between loans backed by the government vs. private capital. Reducing premiums will slow the ability of FHA to attain the 2 percent minimum capital requirement, thus putting taxpayers at increased risk for another bailout. It also runs counter to the public policy goal of putting more private capital at risk instead of taxpayers.

As Congress examines the proper role of the FHA in the context of comprehensive housing finance reform, it should consider other elements that would benefit consumers and taxpayers alike, including a single industry wide standard on QM (Qualified Mortgages) and a common sense approach to FHA loan limits tied to current home prices in each geographic region.

FHA and MI can and should be complementary methods of supporting homeownership. Indeed, FHA has traditionally played an important role serving underserved markets. But,

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these respective roles must also protect taxpayers from undue and increased exposure to losses consistent with the goals of housing finance reform. Therefore, it is critically important that the taxpayer-backed FHA become fully solvent, and remain focused on the important core mission it was designed to serve.

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