JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

**M E M O R A N D U M**

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: February 8, 2013

Subject: February 13, 2013, Full Committee Hearing on "Bailout, Bust, or Much Ado About Nothing?: A Look at the Federal Housing Administration's 2012 Actuarial Report"

---

On Wednesday, February 13, 2013, at 10:00 a.m. in room 2128 of the Rayburn House Office Building, the Financial Services Committee will hold a hearing on "Bailout, Bust, or Much Ado About Nothing?: A Look at the Federal Housing Administration's 2012 Actuarial Report." The hearing will examine the financial status of the Federal Housing Administration (FHA) and the actuarial review of the FHA's Mutual Mortgage Insurance Fund (MMIF) for Fiscal Year 2012, released by the Department of Housing and Urban Development (HUD) on November 16, 2012.

The witness at the hearing will be Ms. Carol J. Galante, Federal Housing Commissioner and the Assistant Secretary for Housing.

**The Role of the Federal Housing Administration**

The National Housing Act of 1934 established the FHA, and its mission was to provide federal mortgage insurance in order to broaden homeownership, protect lending institutions, and stimulate the building industry. Before the FHA was established, home mortgages did not exceed 50 percent of home values and were short term, lasting no longer than five years. At the end of the fifth year, homeowners had to pay their mortgages in full or roll them over. During the Great Depression, lenders were unable or unwilling to roll over loans that came due. As a result, many borrowers lost their homes and lenders lost money because property values declined significantly.

The FHA was established to provide stability and liquidity in the market. Its creation fostered the 30-year, fixed-rate mortgage and led to standardized mortgages. The FHA does not originate loans, but rather insures mortgages issued by banks and other lenders. The FHA is intended to be self-funded: premiums paid by homeowners for FHA mortgage insurance are used to cover losses when loans default.

During the housing boom of the mid-2000s, the FHA's share of the mortgage market fell to under two percent of mortgage originations (measured by dollar volume) at the end of 2006. As housing prices began to decline, lenders tightened their underwriting criteria and the FHA began playing a larger role in the mortgage market. The Congressional Research Service has reported that during FY2010, the FHA guaranteed nearly 40 percent of mortgages originated or refinanced, which corresponds to approximately 1.1 million homebuyers. FY 2010 was the second time that the FHA has assisted more than 1 million homebuyers in a single year. According to the FHA, the federal mortgage insurance program currently insures more than $1 trillion worth of mortgages on more than 7 million loans.

In recent years, more homebuyers have turned to FHA-insured loans to take advantage of its lower down-payment requirements, which are currently set at 3.5 percent of the property's appraised value. Larger down payments make it more difficult for first-time and low-income homebuyers to purchase houses; thus, when banks and private mortgage insurance companies tightened their underwriting criteria and required down payments greater than 3.5 percent, many borrowers turned to FHA-insured mortgages as an alternative.[1]

At the same time that FHA's market share has grown, the FHA—like most other participants in the mortgage market—faces higher default rates. The FHA thus finds itself supporting the mortgage market by insuring new home loans at the same time that it seeks to shore up the stability of its single-family insurance fund, known as the Mutual Mortgage Insurance Fund (MMIF). The MMIF's capital reserve ratio—which is a measure of the MMIF's strength—fell below two percent for the first time in FY 2010 to 0.50 percent. By statute, the FHA is required to maintain the MMIF's capital reserve ratio at 2 percent. The 2-percent capital reserve ratio was established by in the Omnibus Budget Reconciliation Act of 1990, at a time when many were concerned about the solvency of the FHA. Since then, the FHA's ability to meet the 2-percent capital reserve requirement has been a measure of the strength and stability of its MMIF.

**FHA's FY 2012 Actuarial Report and Health of Single-Family Insurance Fund**

On November 16, 2012, the Department of Housing and Urban Development (HUD) released the FHA's FY 2012 Actuarial Report, which showed further deterioration in the MMIF's capital reserve ratio. During FY 2012, the MMIF's capital reserve ratio fell to negative 1.44 percent in FY 2012, which means that the FHA does not have sufficient reserves to cover its expected losses. The FY 2012 Actuarial Report also noted that the MMIF's economic value was negative $16.3 billion, which is the projected amount the FHA

---

[1] Darryl E. Getter, "Federal Housing Administration (FHA) and Risky Lending," CRS Report for Congress R40937, June 10, 2010, available at http://www.crs.gov/Products//r/pdf/R40937.pdf.

would lose if it stopped insuring new mortgages and covered its projected losses. The MMIF's negative $16.3 billion economic value represents a decrease of $17.49 billion from its $1.19 billion economic value at the end of FY 2011, which resulted from further declines in national home prices, more loans having elevated default potential, and uncertain economic conditions.

The FHA is thus vulnerable to further defaults. To cover these defaults, the FHA may be required to resort to its "permanent indefinite authority" to draw funds directly from the U.S. Treasury to pay unexpected increases in insurance claims. Because the FHA guarantees 100% of the loan amount on the mortgages it insures and is ultimately backed by the federal government, a large number of defaults could result in significant losses to the FHA, and those losses may ultimately be borne by taxpayers. Nonetheless, the FY 2012 actuarial report does not necessarily mean that FHA will draw funds from the Treasury. Congress and the public will have a better sense of whether the FHA will draw funds from the Treasury when the Obama Administration releases its FY 2013 budget proposal in February 2013: if the FHA expects to draw funds from the Treasury, the President's budget will contain an estimate of the amount that it expects to borrow to cover shortfalls.

**Concerns about the Solvency of the MMIF**

On February 6, 2013, the Committee on Financial Services received testimony from a panel of experts voicing concerns about the solvency of the MMIF and the expansion of the FHA beyond its historical mission. Witnesses at that hearing warned that the FHA's current lending practices are potentially harming many of the very low and moderate income individuals FHA purports to help. Concerns were raised that the FHA's current practice of insuring high dollar value, low FICO score mortgage loans with minimal down payments could be sowing the seeds of the next housing crisis. Because FHA can play an important role in helping creditworthy homebuyers – especially those of modest means – obtain access to credit to purchase a home, the witnesses urged that prudent and targeted steps be taken to restore the financial health of the FHA's insurance fund.

# # #