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Leading the News
How FHA Could Help Homeowners

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WASHINGTON -- As the subprime-mortgage crisis ripples through the broader housing market, the Bush administration is eyeing an often overlooked federal mortgage insurer to help low- and middle-income homeowners avoid foreclosure.

President Bush has balked at allowing mortgage giants Fannie Mae and Freddie Mac to buy more mortgages for their portfolios to ease the credit crunch triggered by rising defaults on home loans to borrowers with poor credit. But he said earlier this month that he supports giving the Federal Housing Administration more flexibility to help those facing foreclosure refinance their homes.

Treasury Secretary Henry Paulson, meanwhile, has instructed staff to work with the Housing and Urban Development department, which oversees FHA, to find ways to help individuals caught in the fallout of the credit crunch.

The administration is looking to FHA to offer refinancing options to homeowners, including those who aren't yet in default or foreclosure, but who are at risk of falling behind in their payments on mortgages that were structured to offer payments that were very low at first but then escalated.

The effort is likely to jump-start legislation in Congress to give the housing authority more tools to assist homeowners. Senate Banking Chairman Christopher Dodd (D., Conn.), said recently that FHA reform will be among his top priorities when Congress returns from its August recess. The House Financial Services Committee passed a bill in June that is expected to head to the full House this fall.

For decades, the New Deal-era agency was used by low- and middle-income home buyers who had little or poor credit and would have trouble getting a loan in the primary market. The FHA didn't originate loans, but insured them against default by somewhat risky buyers, giving lenders an incentive to issue a mortgage.

In recent years, the agency lost market share as the market for subprime loans exploded and home buyers of all income levels were offered a range of exotic loan products, such as no-money-down mortgages and interest-only payments. While FHA-insured loans once accounted for roughly 15% of the mortgage market, that number has fallen below 5%.

But many buyers who got subprime loans are beginning to have trouble making their mortgage payments as the attractive initial "teaser" interest rates are reset at much higher levels. While many of those buyers believed they could refinance their loans, that has become much harder as mortgage lenders tighten their standards in the face of defaults and foreclosures. The Center for Responsible Lending estimates as many as 2.2 million loans will reset over the next two years.

FHA says it is constrained from doing more now because of limits on the size of the loans it can back and some requirements that borrowers must meet. While its refinancing business has picked up and the agency expects to refinance about 120,000 loans this year, FHA officials say they could easily double that amount if given greater flexibility.

Among the options being discussed in Congress is eliminating or reducing the required 3% down payment, raising the size of the loans FHA can insure to as much as $417,000 from $362,790, and being able to charge insurance premiums based on a borrower's risk instead of a one-size-fits-all rate.

Federal Housing Commissioner Brian Montgomery said the current rules effectively prevent FHA from helping borrowers in high-cost states, such as California and New York. Most of the loans it insures are in places such as Texas and the Midwest.

For the Bush administration, backing FHA reform offers a way to straddle the growing calls for government assistance to those caught in the subprime mess without advocating a financial bailout.

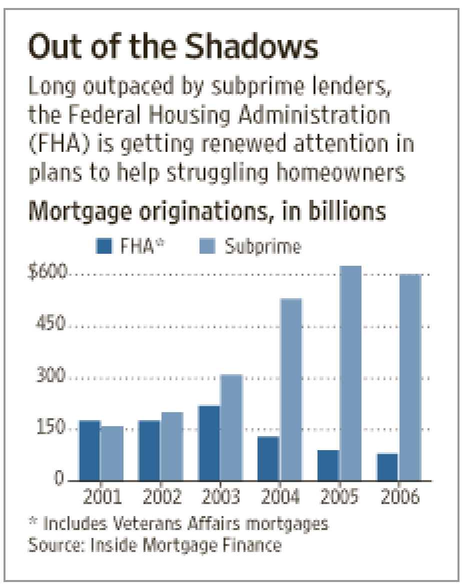
Fannie and Freddie, backed by a host of Democratic lawmakers, have argued they could provide liquidity to the rattled housing market if allowed to grow their portfolios beyond strict limits. Their portfolios are capped in part because of accounting scandals at the government-sponsored entities and Mr. Bush has said Congress should pass long-awaited reforms that would tighten oversight of Fannie and Freddie before allowing them to grow.

Still, an administration official said the government is sensitive to the need to help minimize "collateral damage" from the subprime woes, such as massive foreclosures that could hit certain neighborhoods hard and affect property values broadly. To that end, Treasury and HUD are looking to find ways to assist borrowers who are creditworthy, but who got caught in a pinch and are facing higher mortgage payments than they can afford.

One challenge for the administration is trying to identify borrowers who are likely to get hit with a change in their loan payment -- known as a reset -- that could force them to default on their mortgage, and then figuring out ways to help them refinance. Among the possible options are for government agencies such as FHA or Fannie Mae and Freddie Mac to refinance some of those loans at a lower interest rate.

But not everyone is convinced, and FHA reform may run into trouble in the Senate. Alabama Sen. Richard Shelby, the ranking Republican on the Senate Banking Committee, has expressed concern about expanding FHA, saying it could ultimately hurt taxpayers.

"One lesson learned from the current pattern of defaults and delinquencies in the subprime market is that those borrowers with little or no equity in their home will be the most likely to fail," he said at a hearing last month. "We must approach any attempt to expand the program or lower the program's standards with great caution."



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