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The Streamlined FHA Downpayment Program

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Summary

The National Housing Act was amended in FY1999 to permit the Federal Housing Administration (FHA) to use a simplified formula in computing the required downpayment for borrowers purchasing homes with FHA-insured loans. The authority to use that formula has been extended several times. The FHA Downpayment Simplification Act of 2002, P.L. 107-326, has made the simplified formula a permanent part of the National Housing Act. This fact sheet will be updated to reflect any legislative activity.

Legislative History

In general, Section 203(b) of the National Housing Act (P.L. 73-479, as amended) provided that the maximum mortgage under that section could not exceed the following summation: 97% of the first $25,000 of the property value, 95% of the value between $25,000 and $125,000, and 90% of the value in excess of $125,000. Subtracting the result of that calculation from the sales price or property value gives the minimum downpayment required for the transaction.

This was a somewhat cumbersome process for determining the downpayment. Section 426 of P.L. 104-204, the Department of Housing and Urban Development (HUD) FY1997 Appropriations Act, enacted a simpler method of calculating the downpayment. The calculation applied only to loans made in Alaska and Hawaii during FY1997. Under this Act, the maximum FHA loan would be the sum of the amount of mortgage insurance financed in the loan[1] plus either of the following:

- 98.75% of the value of the property for a property appraised at $50,000 or less;

[1] Borrowers must pay to FHA an insurance premium of 1.5% of the loan amount, and borrowers have a choice of paying the insurance in cash or having it added to the loan. To minimize their out-of-pocket expenses, most borrowers opt to have the insurance included in their FHA-insured loan.

- 97.65% of the value of the property for a property valued in excess of $50,000 but less than $125,000;
- 97.15% of the value of the property for a property valued at $125,000 or more;
- 97.25% of the value of the property for a property valued in excess of $50,000 that is located in an area of the state for which the average closing costs exceed 2.1% of the average closing costs for the state.

Section 211 of P.L. 105-65, the FY1998 HUD Appropriations bill, extended the streamlined downpayment program through FY1998 for loans insured in Alaska and Hawaii. The conferees on the bill directed HUD to study the proposal to streamline the downpayment formula and explain its impact if it were expanded to the continental United States. HUD was directed to examine how the proposed downpayment formula would favorably or adversely affect each state, how it would impact the FHA insurance fund, whether it would improve homeownership opportunities for low- and moderate-income families, and whether it would cause inappropriate competition between FHA and private mortgage insurance companies. The study was to be completed by March 1, 1998, but was completed on April 21, 1998.

Section 212 of P.L. 105-276, the FY1999 HUD Appropriations Act, extended the streamlined downpayment program through September 30, 2000, and applied it to mortgages originated in all the states. P.L. 106-281 extended the program through October 30, 2000. The FY2001 HUD appropriations act, P.L. 106-377, extended the program through December 31, 2002.

The FHA Downpayment Simplification Act of 2002, P.L. 107-326, has made the simplified formula a permanent part of the National Housing Act.

Impact of the Program

According to the 1998 HUD study, lenders and real estate brokers like the simplified formula because it makes it easier to explain FHA requirements to prospective homebuyers.[2] Low- and moderate-income families who may have thought that homeownership was beyond their reach were able to understand FHA's cash requirements and were given a clear goal to reach toward. For about 9% of borrowers, the downpayment would be lower than under the old system, but the net effect on the average downpayment would be negligible. The study concluded that the simplified formula is not expected to adversely impact the profitability of the FHA insurance fund.

From the HUD study it may be inferred that elimination of the program would not necessarily result in cost saving for the government, and that extension would not necessarily result in increased costs for the government.

[2] A Study of FHA Down Payment Simplification. U.S. Department of Housing and Urban Development, April 21, 1998.