FHA-Insured Home Loans: An Overview

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Summary

The Federal Housing Administration (FHA) was created by the National Housing Act of 1934 in order to broaden homeownership, protect lending institutions, and stimulate the building industry. FHA does not make mortgage loans. Rather, it insures mortgage loans made by private lenders that meet certain underwriting and other criteria, thereby expanding the availability of mortgage credit beyond what may be available otherwise. If the borrower defaults on the mortgage, FHA will repay the lender the remaining amount owed. While FHA insures a range of mortgage types, including multifamily properties and hospital facilities, this report focuses on FHA's single-family insurance program.

FHA requires a minimum downpayment of 3.5% from most borrowers, which is lower than the downpayment required for most other types of mortgages. FHA-insured mortgages cannot exceed a statutory maximum mortgage amount, which varies by area but cannot exceed a specified ceiling in high-cost areas. (The ceiling is currently set at $729,750, but is scheduled to fall to $625,500 after December 31, 2013.) Borrowers are charged fees, called mortgage insurance premiums, in exchange for the insurance.

FHA's share of the mortgage market tends to vary with economic conditions and other factors. In recent years, due to housing market turmoil and a contraction of private lending, FHA has been insuring more mortgages than it had in previous years. In FY2012, FHA insured about 1.2 million new loans with a combined principal balance of over $200 billion. FHA-insured mortgages, like all mortgages, have experienced increased default rates in recent years, leading to concerns about the stability of the FHA insurance fund for single-family mortgages, the Mutual Mortgage Insurance Fund (MMIF). In response to these concerns, FHA has recently adopted a number of policy changes, including changes related to the fees that it charges and its mortgage requirements, in an attempt to limit risk to the MMIF. These policy changes have included increasing mortgage insurance premiums, instituting a minimum credit score requirement, and raising downpayment requirements for borrowers with lower credit scores.

This report briefly discusses the basic features of the FHA program to insure loans on single-family homes and describes some recent changes to program requirements.

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A Brief History of the FHA Home Loan Insurance Program

The Federal Housing Administration (FHA) was created by the National Housing Act of 1934,[1] during the height of the Great Depression, to broaden homeownership, shore up and protect home financing institutions, and stimulate employment in the building industry.

Prior to the creation of FHA, few mortgages exceeded 50% of the property's value and most mortgages were written for terms of five years or less. At the end of the five-year term, the remaining loan balance had to be repaid or the mortgage had to be renegotiated. Borrowers generally had little trouble in obtaining new mortgages. During the Great Depression, however, lenders were unable or unwilling to refinance many of the loans that became due. Thus, many borrowers lost their homes through foreclosure, and lenders lost money because property values were falling. Lenders became wary of the mortgage market.

FHA institutionalized a revolutionary idea: 20-year mortgages on which the loan would be completely repaid at the loan term. If borrowers defaulted, FHA insured that the lender would be fully repaid. Mortgage instruments were standardized, and a new confidence was instilled in the mortgage market. Investment in housing was stimulated, and its ripple effects were felt throughout the economy. Eventually, lenders began to make long-term mortgages without FHA insurance if borrowers made significant downpayments. Over time, 25- and 30-year mortgages have become standard mortgage products.

When the Department of Housing and Urban Development (HUD) was created in 1965, FHA became an agency of HUD. This report discusses the features of the FHA program to insure loans on single-family homes. Single-family homes are defined as properties containing from one to four dwelling units.[2]

Features of the Program

Eligibility and Underwriting Guidelines

FHA-insured loans are available to owner-occupants who can demonstrate the ability to repay the loans according to the terms of the contract. In general, parties who have previously defaulted on a mortgage are not eligible for FHA-insured loans for at least three years. FHA-insured loans must be underwritten in accordance with accepted practices of prudent lending institutions and FHA requirements.[3] The FHA credit analysis worksheet is used to examine the applicant's personal and financial status, monthly shelter expenses, funds required for closing expenses, effective monthly income, and debts and obligations.

[1] The National Housing Act is P.L. 73-479, and is codified at 12 U.S.C. 1701 et seq.

[2] FHA also insures other types of mortgage loans, including mortgages for multifamily properties, nursing homes, and hospitals, but these insurance programs are not discussed in this report.

[3] FHA's underwriting and eligibility requirements can be found in HUD Housing Handbook 4155.1, "Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans," http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4155.1.

As a general rule, the applicant's prospective mortgage payment should not exceed 31% of gross effective monthly income. The applicant's total obligations, including the proposed housing expenses, should not exceed 43% of gross effective monthly income. If these ratios are not met, the borrower should present compensating factors, such as savings history and past credit management.[4]

Effective October 4, 2010, FHA imposed a minimum credit score requirement of 500 and increased downpayment requirements for borrowers with credit scores below 580.[5] See the "Downpayment" section for more information on downpayment requirements for FHA-insured loans.

Maximum Mortgage

There is no income limit for borrowers seeking FHA-insured loans. However, FHA-insured mortgages cannot exceed a maximum mortgage amount set by law. The maximum mortgage amounts allowed for FHA-insured loans vary by area, and different limits are in effect for one-family, two-family, three-family, and four-family properties. The limits are subject to a statutory floor and ceiling; the loan limit in a given area cannot be lower than the floor, nor can it be higher than the ceiling.[6]

The maximum mortgage amounts have been amended several times in recent years. In early 2008, Congress enacted the Economic Stimulus Act of 2008 (ESA, P.L. 110-185), which temporarily increased the maximum mortgage amounts to 125% of area median home prices, with a floor of $271,050 and a high-cost area ceiling of $729,750.[7] This temporary increase was enacted in response to tightening lending standards as the mortgage market began to deteriorate. As both lenders and private mortgage insurers tightened their underwriting requirements, fewer borrowers were able to qualify for loans without FHA insurance or other types of guarantees. However, the FHA loan limits prevented some borrowers from being able to purchase a home with an FHA-insured mortgage, particularly in high-cost markets. The increased loan limits allowed more borrowers to qualify for FHA-insured mortgages.[8]

The Housing and Economic Recovery Act (HERA, P.L. 110-289) established new permanent statutory limits of 115% of area median home prices, with a floor of $271,050 and a high-cost area ceiling of $625,500. These limits were generally higher than the pre-ESA limits, but lower in many cases than the temporary limits established by ESA. However, the American Recovery and

[4] See Chapter 4, Section F of HUD Housing Handbook 4155.1 at http://portal.hud.gov/hudportal/documents/huddoc?id=4155-1_4_secF.pdf.

[5] U.S. Department of Housing and Urban Development, Mortgagee Letter 2010-29, September 3, 2010, http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-29ml.pdf.

[6] The FHA maximum mortgage amounts are codified at 12 U.S.C. §1709(b)(2). The statute allows for special higher limits for Alaska, Hawaii, Guam, and the Virgin Islands. To look up the maximum mortgage amount for a specific area, see HUD's website at https://entp.hud.gov/idapp/html/hicostlook.cfm.

[7] Immediately prior to ESA's enactment, the limits had been set at 95% of area median house prices, with a ceiling of $362,790 and a floor of $200,160 for a one-unit home. See U.S. Department of Housing and Urban Development, Mortgagee Letter 2008-02, January 18, 2008, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2008ml.

[8] ESA also raised the limit on the size of mortgages that Fannie Mae and Freddie Mac can purchase, known as the conforming loan limit, in high-cost areas.

Reinvestment Act of 2009 (ARRA, P.L. 111-5) amended the maximum mortgage amounts for calendar year 2009, setting them at the higher of (1) the 2008 limits set in ESA, or (2) the original 2009 limits set in HERA. Since the floor is the same under both ESA and HERA, the floor is set at $271,050 under ARRA. Since the high-cost area limit is higher under HERA, the high-cost area limit is set at $729,750 under ARRA.[9] Since ESA set the limits for all other areas at 125% of 2007 area median home prices while HERA set the limits at 115% of more current area median home prices, which of these limits is higher will vary by area.[10]

The ARRA limits that set the maximum mortgage amount at the higher of the ESA or HERA limits have been extended several times, most recently by the Consolidated and Further Continuing Appropriations Act, 2012 (P.L. 112-55), which was enacted after the last extension had expired at the end of FY2011 and the limits briefly fell to their HERA levels. P.L. 112-55 extends the ARRA limits until December 31, 2013. Unless Congress acts to extend the ARRA limits beyond December 31, 2013, the maximum mortgage amounts will revert to their HERA levels at that time, with the ceiling in high-cost areas falling to $625,500 for a one-unit home, and the maximum mortgage amounts falling in some areas between the floor and the ceiling as well.

The FHA loan limits in effect until December 31, 2013, are summarized in **Table 1**.

[9] The statutory ceilings and floors are set as a percentage of the Freddie Mac conforming loan limit, not as dollar amounts. Currently, the floor is set at 65% of the conforming loan limit and the ceiling is set at 175% of the conforming loan limit. The Freddie Mac conforming loan limit is currently $417,000, so the floor is $271,050 (65% of $417,000), and the ceiling is $729,750 (175% of $417,000). Prior to the Economic Stimulus Act of 2008 (ESA), the floor was set at 48% of the Freddie Mac conforming loan limit, and the ceiling was set at 87% of the conforming loan limit. Congress can change the ceilings and floors either by 1) changing the percentages of the Freddie Mac conforming loan limit that constitute the ceiling and the floor, or 2) changing the Freddie Mac conforming loan limit itself.

[10] FHA calculates area-by-area limits each year based on the prior year's area median home price data, so the actual limit in a given area can change from year to year. The ESA limits are 125% of 2007 area median home prices. The original HERA limits were 115% of 2008 area median home prices, while current HERA limits would be 115% of the most recent area median home price data available. FHA has followed a policy of not allowing HERA limits to fall relative to the original HERA limits, so if current HERA limits (based on more recent area median home prices) are lower than the original HERA limits (based on 2008 area median home prices), FHA uses the original HERA limits for the purposes of calculating the maximum mortgage amount in that area. For the maximum mortgage amounts in each area for calendar year 2013, see FHA Mortgagee Letter 12-26, "Federal Housing Administration Maximum Loan Limits, Effective Period: January 1, 2013 through December 31, 2013," http://portal.hud.gov/hudportal/documents/huddoc?id=12-26ml.pdf.

Table 1. FHA Maximum Mortgage Amounts, through December 31, 2013

Property Size	High-Cost Area[a] (Upper Limit)	All Other Areas	Low-Cost Area[b] (Lower Limit)
1-family	$729,750	The higher of 125% of the 2007 area median home price or 115% of 2008 or later area median home prices	$271,050
2-family	$934,200	The higher of 125% of the 2007 area median home price or 115% of 2008 or later area median home prices	$347,000
3-family	$1,129,250	The higher of 125% of the 2007 area median home price or 115% of 2008 or later area median home prices	$419,425
4-family	$1,403,400	The higher of 125% of the 2007 area median home price or 115% of 2008 or later area median home prices	$521,250

Source: P.L. 112-55, FHA Mortgagee Letter 11-39, and FHA Mortgagee Letter 12-26

Note: FHA mortgage limits by state, county, and MSA are available at https://entp.hud.gov/idapp/html/hicostlook.cfm.

a. Areas where the higher of 125% of the 2007 area median home price or 115% of 2008 or later area median home prices exceeds 175% of the Freddie Mac limit. The National Housing Act provides that mortgage limits for loans in Alaska, Guam, Hawaii, and the Virgin Islands may be adjusted up to 150% of the statutory ceiling.

b. Areas where the higher of 125% of the 2007 area median home price or 115% of the 2008 area median home price is lower than 65% of the Freddie Mac limit.

Loan Term

FHA-insured mortgages may be obtained with loan terms of up to 30 years.

Downpayment

FHA requires a lower downpayment than most other types of mortgages. Under changes made by the Housing and Economic Recovery Act of 2008 (HERA, P.L. 110-289), borrowers are required to contribute at least 3.5% in cash or its equivalent to the cost of acquiring a property with an FHA-insured mortgage. (Prior law had required borrowers to contribute at least 3% in cash or its equivalent.) Amounts borrowed from a family member are considered as cash for this purpose. Prohibited sources of the required funds are the seller or any entity that financially benefits from the transaction, or any third party that is directly or indirectly reimbursed by the seller or by anyone that would financially benefit from the transaction.[11] HUD has interpreted the 3.5% cash contribution as a downpayment requirement and has specified that contributions toward closing costs cannot be counted toward it.[12]

[11] For more information on seller-funded downpayment assistance programs and FHA, see CRS Report RS22934, *Treatment of Seller-Funded Downpayment Assistance in FHA-Insured Home Loans*, by Bruce E. Foote.

[12] U.S. Department of Housing and Urban Development, Mortgagee Letter 2008-23, September 25, 2008, http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_19737.pdf.

FHA guidelines put in place beginning on October 4, 2010 require a 10% downpayment from borrowers with credit scores between 500 and 579, while borrowers with credit scores of 580 or above are still required to make a downpayment of at least 3.5%. FHA no longer insures loans made to borrowers with credit scores below 500.[13]

Owner Occupancy

Generally, for loans closed on or after December 15, 1989, borrowers must intend to occupy the property as a principal residence. Property that has been acquired by FHA as a result of default or foreclosure may be sold to owner-occupants or investors, and in some cases the borrowers may obtain FHA-insured loans.

Eligible Loan Purposes

FHA-insured loans may be used to purchase one-family detached homes, townhomes, rowhouses, two- to four-family buildings, manufactured homes and lots, and condominiums in developments approved by FHA.[14] FHA-insured loans may also be obtained to build a home; to repair, alter, or improve a home; to refinance an existing home loan; to simultaneously purchase and improve a home; or to install a solar heating and cooling system or other weatherization improvements.

Mortgage Insurance Fees

Borrowers of FHA-insured loans pay an up-front mortgage insurance premium (MIP) and annual mortgage insurance premiums. These premiums are set as a percentage of the loan amount. The maximum amounts that FHA is allowed to charge for the annual and the upfront premiums are set in statute. However, since these are maximum amounts, HUD has the discretion to set the premiums at lower levels.

Annual Mortgage Insurance Premiums

In August 2010, President Obama signed P.L. 111-229, which raised the maximum annual mortgage insurance premium that FHA can charge. The amount of the maximum annual premium varies based on the loan's initial loan-to-value ratio: (1) if the loan-to-value ratio is 95% or higher, the maximum annual premium is 1.55% of the loan balance; (2) if the loan-to-value ratio is less than 95%, the maximum annual premium is 1.5% of the loan balance.[15]

FHA has increased the actual premiums it charges several times in recent years as a way to bring more money into the FHA insurance fund.[16] As of April 1, 2013, FHA is charging 1.35% of the

[13] U.S. Department of Housing and Urban Development, Mortgagee Letter 2010-29, September 3, 2010, http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-29ml.pdf.

[14] Particular requirements that apply to FHA insurance of manufactured housing, condominium, and co-op loans are described in FHA Mortgagee Letters, which are available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/.

[15] These annual mortgage insurance premiums apply for mortgages with loan terms that exceed 15 years. Mortgages with loan terms of 15 years or fewer are subject to lower annual mortgage insurance premiums.

[16] Most of the changes to the mortgage insurance premiums in recent years have been made administratively by FHA, (continued...)

loan balance for mortgages where the loan-to-value ratio is above 95%, and 1.30% of the loan balance for mortgages where the loan-to-value ratio is 95% or below.[17] This premium applies to most single-family mortgages.[18]

Since June 11, 2012, FHA has also charged a higher annual mortgage insurance premium on loans with a principal balance that exceeds $625,500. Currently, for loans above this amount, the annual mortgage insurance premium is 1.55% for mortgages with a loan-to-value ratio above 95%, and 1.50% for mortgages with a loan-to-value ratio of 95% or below. The maximum mortgage amount that FHA would have been allowed to insure in high-cost areas would have been $625,500 if the maximum mortgage amounts had remained at their HERA levels. However, since previously higher maximum loan amounts were reinstated, the maximum mortgage amount that FHA can insure in high-cost areas is $729,750. (See the "Maximum Mortgage" section for more information on the recent history of the maximum mortgage amounts.)

Up-Front Mortgage Insurance Premiums

HERA increased the maximum up-front mortgage insurance premium that FHA is permitted to charge to 3% from 2.5% of the mortgage amount for a borrower who has not received homeownership counseling, and to 2.75% from 2% of the mortgage amount for a borrower who has received homeownership counseling. Currently, FHA is not charging different up-front premiums to borrowers who do and do not receive homeownership counseling.

As of April 9, 2012, HUD has set the up-front premium at 1.75% of the loan amount, whether or not the borrower received homeownership counseling.[19] This premium applies to most single-family mortgages.[20]

Table 2 shows the annual and up-front mortgage insurance premiums that are currently in effect.

(...continued)

although the Temporary Payroll Tax Cut Continuation Act of 2011 (P.L. 112-78), enacted on December 23, 2011, required FHA to increase the annual mortgage insurance premium it charges by 10 basis points (one-tenth of one percentage point).

[17] U.S. Department of Housing and Urban Development, Mortgagee Letter 13-04, "Revision of Federal Housing Administration (FHA) Policies Concerning Cancellation of the Annual Mortgage Insurance Premium (MIP) and Increase to the Annual MIP," January 31, 2013, http://portal.hud.gov/hudportal/documents/huddoc?id=13-04ml.pdf. FHA charges lower annual premiums for mortgages with terms of 15 years or less.

[18] These premium changes do not apply to certain FHA programs, including Title I loans and Home Equity Conversion Mortgages (HECMs). Furthermore, as of June 11, 2012, FHA decreased the annual mortgage insurance premium to 0.55% of the loan amount for streamline refinance transactions where the original loan was endorsed on or before May 31, 2009.

[19] U.S. Department of Housing and Urban Development, Mortgagee Letter 12-4, "Single Family Mortgage Insurance: Annual and Up-Front Mortgage Insurance Premiums – Changes," March 6, 2012, http://portal.hud.gov/hudportal/documents/huddoc?id=12-04ml.pdf.

[20] The premium changes do not apply to certain FHA programs, including Title I loans and Home Equity Conversion Mortgages (HECMs). Furthermore, as of June 11, 2012, FHA decreased the up-front mortgage insurance premium to 0.01% of the loan amount for streamline refinance transactions where the original loan was endorsed on or before May 31, 2009.

Table 2. Annual and Up-Front Mortgage Insurance Premiums

As of April 1, 2013

	Annual Premium	Up-Front Premium
Principal balance at or below $625,500		
LTV <= 95%	1.30%	1.75%
LTV > 95%	1.35%	1.75%
Principal balance above $625,500		
LTV <=95%	1.50%	1.75%
LTV > 95%	1.55%	1.75%

Source: FHA Mortgagee Letter 12-4 and FHA Mortgagee Letter 13-04.

Notes: These premiums apply to most FHA-insured single-family loans, with certain exceptions (such as certain streamline refinance transactions and FHA-insured reverse mortgages). Lower annual premiums are charged for mortgages with a loan term of 15 years or fewer.

Premium Refunds and Cancellations

In the past, if borrowers prepaid their loans, they may have been due refunds of part of the up-front insurance premium that was not "earned" by FHA. The refund amount depended on when the mortgage closed and declined as the loan matured. The Consolidated Appropriations Act 2005 (P.L. 108-447) amended the National Housing Act to provide that, for mortgages insured on or after December 8, 2004, borrowers are not eligible for refunds of up-front mortgage insurance premiums except when borrowers are refinancing existing FHA-insured loans with new FHA-insured loans. After three years, the entire up-front insurance premium paid by borrowers who refinance existing FHA-insured loans with new FHA-insured loans is considered "earned" by FHA, and these borrowers are not eligible for any refunds.[21]

The annual mortgage insurance premiums are not refundable. Beginning with loans closed on or after January 1, 2001, FHA had followed a policy of automatically cancelling the annual mortgage insurance premium when, based on the initial amortization schedule, the loan balance reached 78% of the initial property value.[22] However, for loans insured on or after June 3, 2013, FHA will continue to charge the annual mortgage insurance premium for the life of the loan for most mortgages.[23] This change is in response to concerns about the financial status of the FHA insurance fund. FHA has stated that, since it continues to insure the entire remaining mortgage amount for the life of the loan, and since premiums were cancelled on the basis of the loan amortizing to a percentage of the initial property value rather than the current value of the home, FHA has had to pay insurance claims on defaulted mortgages where the borrowers were no longer paying annual mortgage insurance premiums.[24]

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[21] FHA Mortgagee Letter 05-03, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2005ml.

[22] See FHA Mortgagee Letter 00-38, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2000ml.

[23] FHA Mortgagee Letter 13-04, available at http://portal.hud.gov/hudportal/documents/huddoc?id=13-04ml.pdf. Borrowers whose FHA-insured mortgages have loan-to-value ratios of 90% or lower at origination will be able to stop paying the annual mortgage insurance premiums after 11 years.

[24] U.S. Department of Housing and Urban Development, *Fiscal Year 2012 Annual Report to Congress on the Financial* (continued...)

Interest Rates

The interest rate on FHA-insured loans is negotiated by the borrower, seller, and lender. The borrower has the option of selecting a loan with an interest rate that is fixed for the life of the loan or one on which the rate may be adjusted annually.

Defaults and Loss Mitigation

A mortgage is considered delinquent any time a payment is due and not paid. Once the borrower is 30 days late in making a payment, the mortgage is considered to be in default. In general, mortgage servicers may initiate foreclosure on an FHA-insured loan when three monthly installments are due and unpaid, and they must initiate foreclosure when six monthly installments are due and unpaid, except when prohibited by law.[25] A program of loss mitigation strategies was authorized by Congress in 1996 to minimize the number of FHA loans entering foreclosure,[26] and has since been revised and expanded to include additional loss mitigation options. The loss mitigation strategies that servicers are instructed to pursue on FHA-insured loans are summarized in **Table 3**.[27]

Additional loss mitigation options are available for certain populations of borrowers. By written agreement with the lender, a borrower in military service may suspend the principal portion of monthly payments and pay interest only for the period of military service, plus three months.[28] On resumption of payment, loan payments are adjusted so that the loan will be paid in full according to the original amortization.[29] In the past, FHA has also temporarily relaxed rules on the use of partial claims and loan modifications in specific areas in response to certain presidentially-declared major disasters, such as Hurricane Katrina.[30]

(...continued)

Status of the Mutual Mortgage Insurance Fund, p. 54, http://portal.hud.gov/hudportal/documents/huddoc?id=FHAMMIF2012.pdf. FHA estimates that about 10% of the losses that FHA incurs on defaulted mortgages occur after the annual mortgage insurance premiums have been cancelled.

[25] 24 C.F.R. 203.355. State law may prohibit the start of foreclosure proceedings within the time frame specified by HUD. Also, military service of the borrower may delay foreclosure proceedings (24 C.F.R. 203.346).

[26] The loss mitigation program replaced an assignment program; under the assignment program, servicers would assign a defaulted loan to FHA, which would pay the claim to the lender and then attempt to help the borrower avoid foreclosure directly. Under the loss mitigation program, servicers are given the responsibility of pursuing loss mitigation options before completing a foreclosure. P.L. 104-99, the Balanced Budget Downpayment Act, I, terminated the mortgage assignment program and authorized additional loss mitigation activities.

[27] FHA Mortgagee Letters instruct FHA servicers on how to pursue loss mitigation strategies. For example, see Mortgagee Letter 2000-05, "Loss Mitigation Program – Comprehensive Clarification of Policy and Notice of Procedural Changes" and Mortgagee Letter 2012-22, "Revisions to FHA's Loss Mitigation Home Retention Options." Additional aspects of FHA's loss mitigation program are addressed in other Mortgagee Letters.

[28] In addition, as amended by HERA, the Servicemembers Civil Relief Act, P.L. 108-189, provides that individuals called into military service may apply to have any legal action against their homes stayed until nine months after the release from military service, and foreclosure can be prevented until one year after release from military service.

[29] 24 C.F.R. 203.345 and 203.346.

[30] See, for example, Mortgagee Letter 2005-46, December 1, 2005, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee/2005ml.

Table 3. Loss Mitigation Strategies

Possible Remedies for FHA Loans in Default	
Special forbearance	Lender/servicer works out a repayment plan that may include partial or suspended payments for a specified period of time.
Loan modification	The original mortgage is modified to include the total unpaid amount due. Changes may be made to the term, interest rate, or type of loan.
Partial claim	FHA provides an interest-free loan to the borrower to pay the arrearage. The borrower must repay FHA at the end of the original loan term or when the property is sold.
FHA-HAMP	The borrower's monthly mortgage payments are reduced to 31% of monthly income using a combination of a loan modification and a partial claim. The partial claim can be used to provide a limited amount of principal forbearance, as well as to repay the arrearage.
Pre-foreclosure sale	Borrower sells the property and uses the proceeds to satisfy the mortgage debt. FHA pays a partial claim to the lender to make up the difference if the property is sold for less than the mortgage amount.
Deed-in-lieu-of-foreclosure	Borrower deeds the property to FHA and is released from the mortgage.

Sources: 24 C.F.R. 203, Subparts B and C; *An Assessment of FHA's Single-Family Mortgage Insurance Loss Mitigation Program Final Report* (Abt Associates, 2000); HUD Mortgagee Letter 2009-23

Notes: FHA announced a restructuring of its home retention loss mitigation options in November 2012. This reorganization removed the partial claim as a standalone option, but allows FHA-HAMP to include a standalone loan modification, a standalone partial claim, or a loan modification and a partial claim used in combination. For more information, see FHA Mortgagee Letter 2012-22.

Program Funding

The FHA home mortgage insurance program is funded by the FHA Mutual Mortgage Insurance Fund (MMIF), which has been sufficient to fund the program without appropriations from Congress.[31] Cash flows into the MMIF from insurance premiums, interest earnings, and proceeds from the sale of foreclosed homes. Cash flows out of the MMIF to cover administrative costs and claims on foreclosed mortgages.

FHA maintains both a Financing Account and a Capital Reserve Account within the MMIF. The Financing Account includes enough funds to cover all expected future losses associated with the MMIF's entire portfolio of outstanding loans, based on current assumptions. The Capital Reserve Account includes additional funds to cover unexpected losses. If there are changes in the expected costs associated with the MMIF's portfolio of outstanding loans, then FHA moves funds between the Financing Account and the Capital Reserve Account as needed to ensure that there are sufficient funds in the Financing Account to cover projected expenses. If FHA ever needs to transfer more funds to the Financing Account than it has in the Capital Reserve Account, it can receive funds from Treasury to make this transfer without congressional action. If this were to occur, the funds that FHA received from Treasury would not be spent immediately, but would be held in the Financing Account and used to pay insurance claims only after the remaining funds in the Financing Account had been spent.

[31] FHA does receive congressional appropriations for salaries and administrative contract expenses related to the MMIF.

Section 205 of the National Housing Act[32] requires HUD to ensure that the MMIF maintains a capital ratio of 2.0% at all times. The capital ratio measures the amount of funds that the MMI Fund currently has on hand, plus the amounts that FHA expects to earn (such as through premiums) or lose (such as through claims paid) on all of the mortgages that it currently insures. It expresses this amount as a percentage of the total dollar volume of mortgages that FHA currently insures. In other words, the capital ratio is a measure of how much FHA expects to have remaining after all future cash flows on the loans that it currently insures have been realized, assuming that FHA did not insure any more loans going forward.

The capital ratio has been below this mandated 2% level since FY2009, and has most recently been found to be *negative* 1.44%.[33] While a negative capital ratio does not mean that FHA is currently out of money, it does suggest that the funds that FHA currently has on hand, combined with the revenue it expects to earn on mortgages that it currently insures, will not be enough to pay for the losses it expects to incur in the future on the loans that it currently insures.[34]

The decline of the capital ratio does not in itself trigger any special assistance from Treasury, but it raises concerns that FHA is more likely to need such assistance in order to hold enough funds in the Financing Account to cover expected future losses.[35] FHA has taken a number of steps designed to return the capital ratio to 2% or more, and it has indicated that it will continue to take more steps to strengthen the insurance fund.[36] The steps that it has already undertaken include increasing the mortgage insurance premiums charged to borrowers; strengthening underwriting requirements, such as by instituting higher downpayment requirements for borrowers with the lowest credit scores; and increasing oversight of FHA-approved lenders.

For more information on the financial status of the MMI Fund, and steps that FHA and Congress have taken to protect the insurance fund, see CRS Report R42875, *The FHA Single-Family Mortgage Insurance Program: Financial Status and Related Current Issues*, by Katie Jones.

Program Activity

In FY2012, FHA insured about 1.2 million new single-family purchase and refinance mortgages that together had an initial loan balance of $213 billion.[37] At the end of FY2012, FHA was

[32] 12 U.S.C. §1711.

[33] U.S. Department of Housing and Urban Development, *Fiscal Year 2012 Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund*, page 35, http://portal.hud.gov/hudportal/documents/huddoc?id=FHAMMIF2012.pdf.

[34] The calculation of the capital ratio does not take into account any mortgages that FHA may insure in the future. It is possible that mortgages insured in the future, combined with policy changes made by FHA or by Congress, could bring in enough additional revenue to pay for future losses on currently insured loans.

[35] FHA has permanent and indefinite budget authority to pay for increased claim expenses, and could receive funds from Treasury without congressional action. If FHA ever needed assistance from Treasury, it would be determined through a re-estimate of expected claim expenses that is performed as part of the annual budget process. If FHA anticipates needing assistance from Treasury, the amount that it anticipates needing would be included in the President's budget request.

[36] For example, see the discussion of policy changes that FHA has made to date and changes that it plans to make in the future beginning on page 52 of HUD's *Fiscal Year 2012 Annual Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance Fund*, November 16, 2012, p. 12, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

[37] U.S. Department of Housing and Urban Development, *Fiscal Year 2012 Annual Report to Congress on the Financial* (continued...)

insuring a total of about 7.7 million single-family loans that together have an outstanding balance of $1.1 trillion.[38] From 1934 through FY2012, FHA has insured a total of over 40 million home loans.[39]

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Status of the FHA Mutual Mortgage Insurance Fund, November 16, 2012, p. 12, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

[38] U.S. Department of Housing and Urban Development, *Monthly Report to the FHA Commissioner on FHA Business Activity*, September 2012," p. 6, http://portal.hud.gov/hudportal/documents/huddoc?id=12sep.pdf. These totals do not include Home Equity Conversion Mortgages (HECMs), which are reverse mortgages insured by FHA.

[39] U.S. Department of Housing and Urban Development, *Fiscal Year 2012 Annual Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance Fund,* November 16, 2012, p. 7, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.