The FHA Modernization Act of 2008

Bruce E. Foote
Analyst in Housing Policy

February 25, 2009

Congressional Research Service
7-5700
www.crs.gov
R40243

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The Federal Housing Administration (FHA) has been insuring lenders against loss on home loans since 1934, and has insured about 35 million homes at a mortgage volume of about $2 trillion. In past years, FHA was often the innovator in testing new mortgage products, but in recent years the private mortgage market has been offering mortgages that appealed to borrowers who otherwise may have sought FHA-insured home loans. As a result, the FHA share of the mortgage market declined. FHA reform measures were debated in previous sessions of Congress, but FHA reform proved controversial and these efforts stalled. Momentum for FHA reform grew as the downturn in the housing market worsened in 2008. Reform measures were introduced in the 110th Congress and some of the provisions were included in the Housing and Economic Recovery Act of 2008, P.L. 110-289, enacted July 30, 2008. Title I of Division B of P.L. 110-289 is cited as the FHA Modernization Act of 2008, and it contains two subtitles. Subtitle A, the Building American Homeownership Act of 2008, makes several amendments to the FHA program that insures loans on single family homes under Title II of the National Housing Act. Subtitle B, the FHA Manufactured Housing Loan Modernization Act of 2008, makes several amendments to the FHA program that insures loans on manufactured housing loan program under Title I of the National Housing. This report discusses the provisions of these subtitles. The changes enacted in these subtitles affect the delivery of FHA-insured home loans in communities throughout the United States. This report may be updated as warranted by issues related to implementing the new law.

Contents

Introduction 1
The FHA Modernization Act of 2008 2
Subtitle A—Building American Homeownership 3
  Maximum FHA Loan Obligation (Limits) 3
  Minimum Cash Investment 3
  Mortgage Insurance Premiums 3
  Mutual Mortgage Insurance (MMI) Fund 4
  Home Equity Conversion Mortgages (HECMs) 4
  Energy Efficient Mortgage Program 5
  Pilot Program for Borrowers Without Sufficient Credit History 5
  Homeownership Preservation 5
  FHA Improvements 5
  Post-Purchase Counseling Eligibility Improvements 6
  Pre-purchase Homeownership Counseling Demonstration 6
  Fraud Prevention 6
  Limitation on Insurance Premium Increases for Multifamily Housing 7
  Risk-Based Premiums 7
Subtitle B—Manufactured Housing Loan Modernization 7
  Purpose 7
  Exception to Limitation on Financial Institutions Portfolio 7
  Maximum Mortgage Limits 8
  Insurance Premiums 8
  Technical Corrections 8
  Revision of Underwriting Criteria 8
  Prohibition of Kickbacks and Unearned Fees 8
  Leasehold Requirements 9

Contacts

Author Contact Information 9

Introduction

The Federal Housing Administration (FHA) has been insuring lenders against loss on home loans since 1934.[1] From 1934 through the end of FY2007, FHA has insured about 34.6 million home loans at a mortgage volume of about $2 trillion.

Though FHA is a mortgage insurer rather than a lender, in earlier years, FHA was often the innovator in testing new mortgage products or processes:

- In 1959, FHA was authorized to acquire mortgages from lenders in order to avoid foreclosure, instead of taking title to the property after the foreclosure.[2]
- In 1961, FHA was authorized to insure loans on condominiums.[3]
- In 1968, the Special Risk Insurance Fund was created in FHA,[4] and through that fund FHA was authorized to insure home loans to low- and moderate-income individuals who, because of credit problems, irregular incomes, or other factors, did not meet the general FHA credit requirements, but who appeared able to achieve homeownership through homeownership counseling.[5]
- In 1974, FHA was authorized to insure loans involving "experimental financing" under which the payments of the borrowers would increase along with expected increases in borrower income.[6]
- In 1988, FHA was authorized to insure reverse mortgages (referred to as home equity conversion mortgages), and FHA-insured reverse mortgages became the first reverse mortgages that were available on a nearly nationwide basis.[7]

By 1995, some argued that the FHA mortgage insurance program was no longer needed because the private market had matured to the point where it could offer a variety of programs to serve the needs of borrowers who previously had been using the FHA program.[8] Until the recent turmoil in the mortgage market, that argument appeared to have some validity. For example, while FHA generally required downpayments of about 3% of the purchase price, the private market offered 100% financing through such products as so-called "piggyback" loans. One popular piggyback loan was known as the "80 - 20 loan" under which a borrower obtained a first trust for 80% of the price of the home and a 20% second mortgage for the balance of the purchase price. The private market is able to vary the percentage of mortgage insurance premiums required from borrowers according to the risk that the borrowers would default on the loans, so that more risky borrowers would pay higher insurance premiums. FHA requires the same amount of mortgage insurance

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

[2] Sec. 114 of the Housing Act of 1959, P.L. 86-372.

[3] Sec. 104 of the Housing Act of 1961, P.L. 87-70.

[4] Sec. 104(a) of the Housing and Urban Development Act of 1968, P.L. 90-448.

[5] Sec 102(a) of the Housing and Urban Development Act of 1968. The program is no longer being used, primarily because the loan limits are too low ($18,000 in general and $21,000 in high cost areas.)

[6] Sec. 308 of the Housing and Community Development Act of 1974, P.L. 93-383.

[7] Sec. 417 of the Housing and Community Development Act of 1987, P.L. 100-242.

[8] J. Linn Allen, FHA is at a Crossroads, and it May Just Get Run Over, Chicago Tribune, Sep 17, 1995. P5.G.

from borrowers regardless of the risk that the borrowers might default. This prevented FHA from providing loans to more risky borrowers, so such borrowers were lost to the private market. In addition, FHA lost loans to the private market simply because the homes in some communities were priced higher than the statutory FHA loan limits, so FHA was not a viable option. According to data made available by the Home Mortgage Disclosure Act, the FHA share of the market had fallen from 16% in 2000 to less than 3% in 2005 and 2006.[9]

The past several Congresses have debated various FHA reform measures designed to modernize the program and permit FHA to offer products to risky borrowers at less cost to borrowers than many of the products offered on the private market.[10] FHA reform, however, proved controversial and these efforts stalled.

The FHA Modernization Act of 2008

In 2008, the general decreases in home values, the increases in home foreclosures, and the meltdown in the mortgage market brought increased interest in FHA as an instrument to add some stability to the mortgage market. Several FHA reform proposals were introduced in the 110th Congress, and provisions from some of the bills were included in H.R. 3221, the Housing and Economic Recovery Act of 2008 (HERA), which was enacted on July 30, 2008, as P.L. 110-289.[11] HERA is omnibus legislation which contains three Divisions—Division A addresses housing finance reform, Division B addresses foreclosure prevention, and Division C addresses tax-related provisions.

Title I of Division B of HERA is cited as the FHA Modernization Act of 2008. It amends the National Housing Act in an attempt to make FHA more competitive with products available on the private market. It does not, however, attempt to compete with zero downpayment loans. HERA takes the opposite approach and increases the downpayment requirements for FHA-insured home loans. Given turmoil in the mortgage market, however, it is doubtful that the private market is presently offering any zero downpayment loans.

The FHA Modernization Act of 2008 (the Act) contains two subtitles. Subtitle A, the Building American Homeownership Act of 2008, makes several amendments to the FHA program that

[9] Robert B. Avery, Kenneth P. Bevoort, and Glen B. Canner, The 2007 HMDA Data, the Federal Reserve Bulletin, V.94, December 23, 2008.

[10] The FHA Reform Act of 1994 (H.R. 4390) was introduced in the 103rd Congress. The FHA Single Family Reform Act of 1996 (H.R. 3742) was introduced in the 104th Congress. In the 106th Congress, FHA reform bills included the Manufactured Housing Improvement Act (H.R. 710 and S. 1452), the FHA Property Inspection Act (H.R. 1797), and a bill to authorize a pilot program to provide homeownership assistance to disabled families (H.R. 2860). In the 107th Congress, reform bills included the FHA First-Time Homebuyer Act (H.R. 859) and the FHA Energy Efficiency Act (H.R. 2834). In the 108th Congress, reform bills included the Zero Downpayment Act of 2004 (H.R. 3755 and S. 2753) and the FHA Loan Single Family Limit Adjustment Act of 2004 (H.R. 4110). In the 109th Congress, reform bills included the FHA Single Family Loan Limit Adjustment Act of 2005 (H.R. 176), the Zero Downpayment Pilot Program Act of 2006 (H.R. 3043), the Expanding American Homeownership Act of 2006 (H.R. 5121 and S. 3535), the Community Partners Next Door Act of 2005 (H.R. 4278), the FHA Manufactured Housing Loan Modernization Act of 2005 (H.R. 2803 and S. 2123), and the FHA Manufactured Housing Loan Modernization Act of 2006 (H.R. 4804).

[11] FHA reform bills included the Community Partners Next Door Act of 2007 (H.R. 172), the Expanding American Homeownership Act of 2007 (H.R. 1752, H.R. 1852, and S. 2325), the American Housing Rescue and Foreclosure Prevention Act of 2008 (H.R. 3221), the FHA Modernization Act of 2007 (S. 2338), The SAFE Act (S. 2734) and the FHA Seller-Financed Downpayment Reform and Risk-Based Pricing Authorization Act of 2008 (H.R. 6694).

insures loans on single family homes under Title II of the National Housing Act. Subtitle B, the FHA Manufactured Housing Loan Modernization Act of 2008, makes several amendments to the FHA program that insures loans on manufactured housing loan program under Title I of the National Housing. The remainder of this report discusses these two subtitles.

Subtitle A—Building American Homeownership

Maximum FHA Loan Obligation (Limits)

The FHA loan limits are set on an area by area basis with a statutory floor and ceiling, and with different limits for 1-, 2-, 3-, and 4-family residences. The Act amends the National Housing Act to set the FHA loan limit for an area to the lesser of (1) 115% of the median price of a 1-family residence, as determined by HUD, or (2) 150% of the Freddie Mac conforming loan limit, except that the limit for an area may not be less than 65% of the Freddie Mac conforming loan limit.[12] The Act provides that the FHA loan obligation is not to exceed 100% of the appraised value of the property. (Sec. 2112)

Minimum Cash Investment

To obtain an FHA-insured loan, prior law required borrowers to contribute at least 3% in cash or its equivalent to the cost of acquiring the property. The Act increases the cash requirement to 3.5% of the sales price. Amounts borrowed from a family member are considered to be cash for this purpose. If the borrowed amount is secured by a lien, the lien must be subordinate to the mortgage. The sum of the lien and the mortgage may not exceed 100% of the appraised value of the property. Prohibited sources of funding for the required 3.5% contribution include: (1) the seller, (2) any entity that financially benefits from the transaction, or (3) any third party that is directly or indirectly reimbursed by the parties in (1) or (2) above.[13] (Sec. 2113)

Mortgage Insurance Premiums

When obtaining an FHA-insured home loan, borrowers are required to pay a mortgage insurance premium to FHA when the loan is obtained (the upfront mortgage insurance premium) and an annual insurance premium during the first several years of the loan. The Act increases the maximum FHA upfront mortgage insurance premium for a borrower who has not received homeownership counseling from 2.5% to 3% of the mortgage amount, and for a borrower that has received homeownership counseling, the upfront mortgage insurance premium is increased from 2% to 2.75% of the mortgage amount. (Sec. 2114)

[12] HERA provides that, as of January 1, 2009, Freddie Mac has a general limit and a high-cost limit. The general limit is $417,000. In areas where 115% of the median home price exceeds $417,000, the Freddie Mac high-cost limit will be the lesser of (1) 115% of the median home price or (2) 150% of the general limit (150% of $417,000 = $625,500). The general limit may be changed on January 1 of each year on the basis of changes in a home price index maintained by the newly created Federal Housing Finance Agency.

[13] For further information on downpayment requirements please see CRS Report RS22934, *Treatment of Seller-Funded Downpayment Assistance in FHA-Insured Home Loans*, by Bruce E. Foote.

Mutual Mortgage Insurance (MMI) Fund

FHA-insured home loans are insured under one of two insurance funds—the Mutual Mortgage Insurance fund (MMI) and the General Insurance/Special Risk Insurance (GI/SRI) fund.[14] Most of the FHA single-family home loans are insured under the MMI fund while multifamily housing, nursing homes, hospitals, and experimental housing loans are insured under the GI/SRI fund. The Act rewrites the section of law governing the MMI fund to: (1) limit loan commitments to the amount specified in appropriations acts for each fiscal year; (2) establish that HUD has the fiduciary responsibility to ensure that the MMI fund remains financially sound; (3) require an annual independent actuarial study of the fund; (4) require quarterly reports to Congress on the status of the fund; (5) require the adjustment of insurance premiums when needed; (6) establish operational goals for the Fund; and (7) provide that the Homeownership Voucher program and the home equity conversion program become obligations of the MMI fund instead of the General Insurance Fund. (Sec. 2118)

Home Equity Conversion Mortgages (HECMs)

Reverse mortgages are mortgages under which elderly homeowners obtain loans to convert their home equity into income, while providing that no repayments are due on the loans for a specified period. Most reverse mortgages provide that no repayments are due until the borrowers die or no longer occupy the property as principal residences. FHA-insured reverse mortgages are known as Home Equity Conversion Mortgages (HECMs).[15]

Under prior law, the loan limits for HECMs were set on an area-by-area basis according to the FHA loan limit for the area in which the property was located. The Act establishes a national HECM loan limit equal to the Freddie Mac conforming loan limit of $417,000. (12 U.S.C. 1715z-20)

The Act further requires that borrowers entering into HECMs must receive counseling by an independent third party that (1) is not associated with, or compensated by, the party that is involved in funding, originating, or servicing the mortgage; or (2) is not involved in the sale of annuities, investments or other financial or insurance products.

The Act amends current law to permit HECMs to be used for home purchase, and to permit owners of cooperatives to obtain HECMs. The Act limits origination fees to 2% of the first $200,000 of the maximum mortgage amount, plus 1% of the mortgage amount in excess of $200,000, but the total origination fee may not exceed $6,000. In subsequent years, FHA is authorized to adjust this maximum origination fee in increments of $500 whenever the percentage change in the Consumer Price Index would produce a number that exceeds $500 when applied to the current maximum origination fee. The Government Accountability Office (GAO) is directed to study the mortgage insurance premiums charged on HECMs to determine the effect of limiting costs and fees under the program.

[14] Different loan products are insured under the General Insurance fund and the Special Risk Insurance fund, but administratively the funds are treated as one.

[15] For more information on reverse mortgages see CRS Report RL33843, *Reverse Mortgages: Background and Issues*, by Bruce E. Foote.

The Act prohibits lenders from requiring a borrower to purchase an insurance, annuity, or other product as a condition of eligibility for a HECM. The Act directs HUD to conduct a study to determine which consumer protection and underwriting standards would ensure that the purchase of such products would be appropriate for the borrowers. (Sec. 2122)

Energy Efficient Mortgage Program

An energy efficient mortgage is an FHA-insured mortgage under which the loan amount has been increased by the cost of improvements to increase the energy efficiency of the property. Prior law provided that the cost of the improvements could not exceed the greater of 5% of the property value or $8,000. The Act provides that the cost of improvements may not exceed the greater of 5% of the property value (up to 5% of the FHA loan limit) or 2% of the appraised value of the property. The Act adds the provision that, in any fiscal year, the number of energy efficient mortgages may not exceed 5% of the number of FHA-insured home loans in the previous fiscal year. (Sec. 2123)

Pilot Program for Borrowers Without Sufficient Credit History

Borrowers without credit histories often have difficulty obtaining home loans. The Act establishes a five-year pilot program under which HUD is directed to establish an automated process for providing alternative credit rating information for prospective borrowers with insufficient credit histories to determine their creditworthiness. Within two years GAO is directed to provide a report to Congress on the number of additional borrowers served by the program and the impact of the program on the safety and soundness of the FHA insurance funds. (Sec. 2124)

Homeownership Preservation

The Act directs HUD and FHA, in consultation with the industry, the Neighborhood Reinvestment Corporation, and other entities involved in foreclosure prevention activities, to develop and implement a plan to improve FHA's loss mitigation process,[16] and to report the plan to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services. (Sec. 2125)

FHA Improvements

The Act authorizes $25 million to be appropriated in each of FY2009 through FY2013 from the negative credit subsidy of the FHA insurance funds to be used for improving technology, processes, program performance, staffing, and fraud elimination in the FHA program.[17] HUD must certify that the insurance premiums charged during the fiscal year would be sufficient to

[16] Loss mitigation refers to the options FHA uses to minimize financial losses to the mortgage insurance fund and to provide assistance to borrowers who are in default, or who are in imminent danger of going into default.

[17] The Federal Credit Reform Act of 1990 was enacted to better capture the government's cost of extending credit. Through accounting and budget changes, the budget now shows whether credit programs have a cost to the government (a positive credit subsidy), break even (zero subsidy cost), or make a "profit" (a negative subsidy cost) before administrative costs are considered. For FHA, a negative credit subsidy (profit) occurs when the present value of cash inflows to the FHA insurance funds exceeds the present value of cash outflows from the funds.

maintain the actuarial soundness of the insurance funds. HUD is directed to conduct a study obtaining recommendations from the mortgage industry on how best to update its processes to conform to the procedures customarily used by the secondary market. Within a 12-month period, HUD is required to report to Congress on its progress towards updating its procedures, processes and staffing. (Sec. 2126)

Post-Purchase Counseling Eligibility Improvements

Under prior law, HUD had authority to make grants to nonprofit organizations to enable the organizations to provide homeownership counseling to homeowners who have, or will have, difficulty in making mortgage payments due to a reduction in the income of the homeowner because of (1) an involuntary loss of or reduction in the employment of the homeowner, the self-employment of the homeowner, or income from the pursuit of the occupation of the homeowner; or (2) any similar loss or reduction experienced by any person who contributes to the income of the homeowner. The Act extends eligibility for counseling to homeowners (1) who experience a significant reduction in household income due to divorce or death; or (2) who experience a significant increase in basic expenses due to medical expenses, divorce, significant property damage that is not covered by insurance, or increases in property taxes. (Sec. 2127)

Pre-purchase Homeownership Counseling Demonstration

The Act establishes a three-year pre-purchase homeownership counseling demonstration program to test the effectiveness of alternative pre-purchase counseling. The counseling may take the form of telephone counseling, individualized in-person counseling, web-based counseling, counseling classes, or any form of counseling that HUD deems appropriate. The counseling is limited to 3,000 homebuyers in any fiscal year who are first-time homebuyers obtaining loans with loan-to-value ratios between 97% and 98.5%. HUD is directed to submit annual reports to the Senate Banking Committee and House Financial Services Committee on the payment history and delinquency rates of program recipients. (Sec. 2128)

Fraud Prevention

Prior law provides for fines up to $1 million, imprisonment for up to 30 years, or both for knowingly making any false statement or report, or willfully overvaluing any land, property, or security, for the purpose of influencing in any way the action of organizations such as the Farm Credit Administration, Federal Crop Insurance Corporation, any Farm Credit Bank, a Federal land bank, a Federal land bank association, a Federal Reserve bank, a small business investment company, a Federal credit union, an insured State-chartered credit union, any institution the accounts of which are insured by the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, any federal home loan bank, the Federal Housing Finance Board, the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Farm Credit System Insurance Corporation, or the National Credit Union Administration Board. The Act adds FHA to this list of organizations. (Sec. 2129)

Limitation on Insurance Premium Increases for Multifamily Housing

The Act provides that FHA insurance premiums for the multifamily housing programs may not be increased above the amounts in effect on October 1, 2006, unless HUD determines that, absent the increase, new appropriations of budget authority would be required to cover the costs of the program. At least 30 days prior to the increase, HUD is required to notify the Senate Banking Committee and the House Financial Services Committee and publish a notice in the Federal Register. (Sec. 2130)

Risk-Based Premiums

For the past few years, the HUD budget has requested the authority for FHA to charge borrowers mortgage insurance premiums which would vary based upon the risk that the borrowers would default. In 2007, FHA concluded that it did not need legislation to implement a risk-based insurance premium policy, and that FHA had authority to do so administratively. A proposal to implement a risk-based premium program was published in the Federal Register on September 20, 2007,[18] and a final rule was published May 13, 2008.[19] The Act places a 12-month moratorium on FHA's planned implementation of risk-based premiums. (Sec. 2133)

Subtitle B—Manufactured Housing Loan Modernization

Purpose

The purposes of this part of the Act are (1) to provide adequate funding for FHA-insured manufactured housing loans for low- and moderate-income homebuyers during all economic cycles in the manufactured housing industry; (2) to modernize the FHA Title I insurance program for manufactured housing loans to enhance participation by Ginnie Mae and the private lending markets; and (3) to adjust the loan limits for Title I manufactured home loan insurance to reflect the increase in costs since such limits were last increased and to index the limits to inflation. (Sec. 2142)

Exception to Limitation on Financial Institutions Portfolio

Prior law provided that the volume of FHA-insured home loans held by a lending institution could not exceed 10% of the dollar volume of all home loans held by the institution. The Act amends the National Housing Act to provide that, except for manufactured home loans, the volume of FHA-insured home loans held by a lending institution may not exceed 10% of the dollar volume of all home loans held by the institution. The intent of the legislation is to encourage lenders to make manufactured home loans. (Sec. 2143)

---

[18] 72 FR 53872

[19] 73 FR 27704

Maximum Mortgage Limits

The loan limits for FHA-insured loans on manufactured homes had not been changed since 1992.[20] The Act increases the loan limits for manufactured homes as follows: (1) a loan to finance the improvement, alteration, or repair of an existing manufactured home is increased from $17,500 to $25,090; (2) a loan to finance the purchase of a manufactured home is increased from $48,600 to $69,678; (3) a loan to finance the purchase of a manufactured home and lot is increased from $64,800 to $92,904; (4) a loan to finance the purchase of a lot by an owner of a manufactured home is increased from $16,200 to $23,226. The Act provides that these loan limits will be adjusted annually by HUD from an index to be developed based on manufactured housing price data collected by the Census Bureau. (Sec. 2145)

Insurance Premiums

Under prior law, FHA was authorized to charge borrowers an annual insurance premium of up to 1% of the loan amount. The Act requires borrowers to pay an upfront insurance premium of up to 2.25% of the loan amount and annual insurance premiums of up to 1% of the loan balance. The Act directs HUD to adjust the insurance premiums as required to maintain a negative credit subsidy for the program. (Sec. 2146)

Technical Corrections

Prior law was silent regarding HUD authority to handle manufactured housing when the borrowers defaulted. The Act provides HUD with general authority to handle and dispose of manufactured housing properties in the case of loan default by the borrower, which is similar to authority HUD now has with regard to FHA single family home loans. (Sec. 2147)

Revision of Underwriting Criteria

The Act directs HUD is to establish underwriting criteria that will ensure the financial soundness of the manufactured housing program. (Sec. 2148)

Prohibition of Kickbacks and Unearned Fees

The Real Estate Settlement Procedures Act of 1974 (RESPA) prohibits the paying or receiving of kickbacks and unearned fees for the referral of real estate business. The Act applies the provisions of RESPA to each sale of a manufactured home financed with an FHA-insured loan or extension of credit and related services. The Act gives HUD the authority to grant exceptions to the provisions of RESPA when deemed necessary. The Act requires HUD to prohibit acts or practices that HUD finds to be unfair, deceptive, or not in the interests of the borrower. (Sec. 2149)

[20] Sec 503(c)(1) of the Housing and Community Development Act of 1992, P.L. 102-550.

Leasehold Requirements

Some manufactured homes are placed on lots that are leased from the owner (usually a manufactured home community). From a lender's perspective, loans for manufactured homes on leased lots carry the risk that the borrower may default if the lease is lost and the homeowner cannot find another place to move the home. Prior law was silent regarding lease requirements. The Act requires that with respect to a mortgage loan to finance a manufactured home intended to be placed on a leased lot in a manufactured home community, the lease must expire at least three years after the origination date of the loan and must be renewable annually thereafter. (Sec. 2150)

Author Contact Information

Bruce E. Foote
Analyst in Housing Policy
bfoote@crs.loc.gov, 7-7805