TERNER CENTER FOR HOUSING INNOVATION UC BERKELEY

Mission Critical: Retooling FHA to Meet America's Housing Needs

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As Congress considers potential reforms to the housing finance system, it is imperative that FHA is a part of these discussions; FHA must be positioned and equipped to perform its complementary and countercyclical role in the nation's housing markets. A reformed conventional mortgage finance system without an appropriately retooled FHA to complement it could threaten access to homeownership for American families and increase risk to taxpayers – precisely the opposite of the intended goals of housing finance reform.

In thinking about what is necessary to retool FHA, providing a critical pathway to homeownership and wealth creation for American families must remain core to FHA's mission and activity. This should include continuing to make mortgage products available that offer low down payments, long-term fixed rate loans, average pricing on mortgage premiums, and a 100 percent insurance guarantee backed by the full faith and credit of the U.S. Government.

Building on these core principles, the recommendations below would make FHA a more efficient, safe, and effective component of the U.S. housing finance system.

1. **Target FHA programs to those who truly need them***.* Today, there is too much overlap between FHA's programs and those of the private market. While some overlap and competition is unavoidable and in some cases even desirable (creating product choice and competitive pricing for consumers), too great an overlap creates undue risk as lenders seek to leverage FHA's insurance guarantee and favorable pricing of Ginnie Mae securities to steer borrowers who could otherwise qualify for a conventional mortgage to FHA-insured products. As a result, the government incurs credit risk that should be borne by the private market. Two actions should be taken to address this:

    - The methodology for setting FHA's loan limits should be refined to better correspond to the diversity of housing markets in which lower-wealth households utilize its programs:

        - FHA's maximum loan limit should be set at 100% of the median house price for a particular geographic region rather than the current 115%; and

        - The use of smaller population-based geographic sub-regions (e.g. zip codes or census tracts) should be employed to better ensure that FHA's loan limits accord with actual market values in a given area.

    - FHA's products should be limited to home purchase loans and refinances of FHA-insured loans.

2. **Reestablish FHA as a Government Corporation.** FHA was subsumed into the U.S. Department of Housing and Urban Development (HUD) after HUD's creation in 1968. While remaining part of the Cabinet level Department and supporting its broad housing goals is appropriate, to be fully effective FHA requires an operational structure that provides it with better budget control and risk management capabilities. All of FHA's mortgage insurance programs – single family, multifamily, and healthcare – should be operated within the reconstituted FHA, while the many rental assistance and regulatory programs currently under the authority of the Federal Housing Commissioner/Assistant

Secretary for Housing should be moved to other areas of HUD.

- FHA should receive a separate individual appropriation from Congress rather than being a component of the larger HUD budget;

- FHA's budget should be derived by receiving a baseline appropriation for its annual expenses, with the remainder of its budget being sourced by retaining a portion of the premium revenue it generates in each fiscal year. These funds should be available for administrative and personnel expenses.

- FHA should be given exemptions from statutes and regulations in areas such as information technology procurement that limit its operational efficiency and management of risk; and

- FHA should have the ability to utilize a pay scale separate from the General Schedule Pay System, as do many of its peer agencies (such as Federal Deposit Insurance Corporation, National Credit Union Administration, and Federal Housing Finance Agency), for select personnel so that it can compensate its employees at levels comparable to those entities and recruit and retain top talent.

3. **Strengthen FHA's capital reserve requirements.** FHA capital reserve requirements were not intended to withstand the level of economic stress of the last recession. If Congress intends for FHA reserves to withstand this type of disruption in the future, both the formula for calculation of the reserves and the reserve requirement itself should be strengthened. Under the current formula, FHA has estimated that it would have needed $30 billion, or a capital reserve ratio of 3 percent, to withstand losses resulting from the severe recession. The reserve methodology could also be modified to better accord with the fluctuations in its business volumes and associated risk that result from its countercyclical role in the mortgage market.

    - Additionally, FHA's forward and reverse mortgage programs should be separated so that each has a distinct insurance fund and capital reserve account. This will prevent situations in which one program is unduly disadvantaged by the poor performance of the other, or conversely, one program's poor results are masked by the stronger performance of the other.

4. **Equip FHA with temporary emergency powers.** Due to the nature of its role in the mortgage market, FHA's insurance volume and risk fluctuates substantially based upon economic conditions, sometimes presenting unexpected and rapidly appearing risks. To manage such risks:

    - The Federal Housing Commissioner should be provided temporary authority to suspend FHA insurance programs or make emergency modifications to regulations governing such programs (for a limited time period); and

    - FHA should be granted a temporary exemption from the Federal Acquisition Regulation (FAR), which would enable it to more rapidly enter into contracts to expand consulting and research activities and/or otherwise engage resources that mitigate risk.

The Federal Housing Administration has become a central component of making the American dream attainable for lower-wealth, first-time, and/or minority households. But it is not fully equipped to meet the needs of current and future generations and the 21st century housing market. FHA needs the flexibility, tools, talent, and resources necessary to both more efficiently and effectively deliver its existing programs and to reemerge as an innovative partner in the development of new approaches to addressing future needs and opportunities in the housing market.