Department of Housing and Urban Development

Eliminate the Federal Housing Administration

RECOMMENDATION

Federal lawmakers should eliminate the Federal Housing Administration (FHA). In so doing, Congress should preclude the transfer of any functions carried out by the FHA to a separate federal government agency, government-sponsored institution, or government-owned corporation.

Until Congress dissolves the FHA, the Secretary of Housing and Urban Development should instruct the FHA to implement the following reforms.

- Increase the initial collateral requirements, interest rates, and premiums to properly account for borrower risk within the mutual mortgage insurance program;
- Decrease the loan limits for program eligibility;
- Cease all new refinance activity; and
- Cease all new activity within its multifamily and health-care-facility mortgage insurance and guarantee programs.

RATIONALE

Congress created the FHA in 1934 in response to the distressed housing market conditions of the early 1930s. There is often confusion, though, about the early mission of the FHA single-family mortgage program in the mistaken belief that the federal government created the FHA to offer access to mortgages to underserved groups of individuals. In fact, the National Housing Act of 1934 authorized the FHA to cover most of the housing market at that time, where the maximum loan amount was approximately three times the then-current median home prices,[1] which underscores the notion that a main goal of the FHA was to stimulate construction jobs, not to assist low-income individuals.

While the focus of the FHA's single-family home loan program extended to high-cost homes in the early years, the FHA did, however, begin with relatively strict underwriting standards compared with those required of most loans today. Indeed, the FHA's history exhibits a long-term drift in underwriting standards and the quality of loans insured under the program. Starting in the mid-1950s, the FHA began to reduce the level of up-front collateral—the down payment—required to take on a home loan through its single-family mortgage program. By 1961, the maximum loan-to-value ratio allowed for new and existing homes was 97 percent (in other words, a 3 percent down payment). More broadly, annual loan data from 1990 to 2014 shows that fewer than 10 percent of FHA-insured loans during those years would have qualified for eligibility during the first two decades the FHA's existence.[2]

Consequently, despite various reform initiatives since the 1930s, the FHA has had trouble meeting safety and soundness guidelines, has undermined the stability of the housing market, and in recent years has needed several billion dollars to cover its losses. In fact, in recent years the FHA required several billion in appropriated funds to cover deficits in the Mutual Mortgage Insurance Fund and the lack of loss reserves in the capital reserve account.[3] In return for the substantial costs to taxpayers, the FHA's mortgage insurance programs have had minimal impact on homeownership rates—indeed, the U.S. homeownership rate is at the same today as it was in the mid-1960s. Research has shown that the FHA's single-family mortgage insurance portfolio has had little effect on increasing total homeownership, and the FHA's home loan program at best accelerated the take up of a mortgage by only a few years.[4]

Moreover, the FHA has expanded the scope of its insurance and guarantee portfolio to include mortgages used in the financing of multifamily (rental) housing and health care facility structures. The FHA explicitly claims that it has a unique market advantage in providing "long-term loan amortization [up to 40 years in some cases] not found with conventional lending sources" regarding the financing of various commercial-based development initiatives in the construction of multifamily and health care facility structures.[5] Yet all of these projects together comprise a small share of the overall FHA mortgage portfolio. These programs have also had the most problems with corruption and waste, and they have a longer history of needing appropriated capital transfers to cover financial shortfalls. Even though the FHA has made recent efforts to increase efficiency in managing these mortgage programs, they are not necessary to maintain robust financing within the housing-finance system.

Overall, in return for the substantial costs to taxpayers, the FHA's mortgage insurance programs have had minimal impact on homeownership rates. This suggests that additional FHA reforms would provide merely temporary financial improvements without adding appreciable benefits to the housing market. Congress should take the steps necessary to shut down the FHA and get the federal government out of the home-financing business.

ADDITIONAL READING

- John L. Ligon, "A Pathway to Shutting Down the Federal Housing Finance Enterprises," Heritage Foundation *Backgrounder* No. 3171, December 21, 2016.
- John L. Ligon and Norbert J. Michel, "The Federal Housing Administration: What Record of Success?" Heritage Foundation *Backgrounder* No. 3006, May 11, 2015.
- Norbert J. Michel and John L. Ligon, "Five Guiding Principles for Housing Finance Policy: A Free-Market Vision," Heritage Foundation *Backgrounder* No. 4259, August 11, 2014.

ENDNOTES

1. John L. Ligon and Norbert J. Michel, "The Federal Housing Administration: What Record of Success?" Heritage Foundation *Backgrounder* No. 3006, May 11, 2015, pp. 2 and 3, http://www.heritage.org/housing/report/the-federal-housing-administration-what-record-success.
2. Ibid., pp. 6–8.
3. Ibid., pp. 7–10.
4. Ibid., pp. 3 and 4.
5. Ibid., p. 11.