

Higher Loan Limits for FHA, Amid Higher Risk?

Published: Tuesday, 15 Nov 2011 | 11:56 AM ET

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CNBC Real Estate Reporte



On the same day that independent auditors [released a report](#) showing the government mortgage insurer, the FHA, has even less cash reserves now than it did last year to cover potential losses, Congress is readying to vote on a measure that would increase the FHA's market share.

Lawmakers, under heavy pressure from housing lobbies, want to reinstate higher loan limits at the FHA, although not at mortgage giants Fannie Mae and Freddie Mac, which are currently under government conservatorship.

The loan limits fell from a maximum \$729,750 to \$625,000 on October first. This affected 600 US counties for FHA, but less than half of that for Fannie and Freddie. FHA is not a mortgage originator but an insurer. It is currently the only low down payment game in town, with a minimum 3.5 percent home buyer investment. It is therefore supposed to be a small share of the mortgage market, but given today's tight underwriting, it's about a third of the market.

Now the FHA's share could get even larger because it would have a hold on a small segment of the market from which Fannie and Freddie would be excluded. So how would that affect FHA's bottom line?

"This is a situation that has never occurred before where FHA has the higher limits and Fannie and Freddie would not," said acting FHA commissioner Carol Galante on a conference call this morning. It could increase FHA volume by ten percent, according to mortgage analyst Brian Chappelle at Potomac Partners.

"The higher limits will help improve FHA's finances. Every recent audit has said higher balance loans perform better than lower balance loans," says Chappelle. "If it wasn't for the FHA loans insured in 2009-2011 (including higher balance loans), FHA would already be needing taxpayer assistance."

Mortgages

LOAN TYPE	RATE	LAST WEEK	APR
30 yr fixed	4.02%	▼	4.06%
30 yr fixed jumbo	4.69%	▼	4.77%
15 yr fixed	3.38%	—	3.51%
15 yr fixed jumbo	4.06%	▲	4.19%
5/1 ARM	2.96%	▼	3.14%
5/1 jumbo ARM	3.14%	▲	3.12%

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But not everyone agrees. The highly influential, Tea Party-conservative Club for Growth slammed the Congressional action: "Including higher FHA loan limits on the heels of this [FHA] audit report is beyond ridiculous...One year ago, Americans sent a message that they wanted to end the subsidies and the bailouts that have crippled our economy. Raising the FHA loan limits again is a step in the exact opposite direction."

Joseph Gyourko, Professor of Real Estate Finance at the Wharton School, says the FHA is in line for a massive government bailout regardless. "Unless the economy makes a swift recovery, my research shows that FHA will need a massive taxpayer bailout--between \$50 and \$100 billion," he wrote in an article. He cites, among other things, the fact that FHA's low down payment requirement, in the midst of still-falling home prices, makes well over half of its insurance portfolio, based on mortgages taken out by borrowers with negative equity in their homes."

Gyourko argues that the FHA is undercapitalized for its risk and that it overestimates the value of its main insurance fund.

The FHA was originally supposed to help lower income borrowers with lower credit scores, but today its mandate seems entirely different. Acting Director Galante even touted the fact that credit scores for FHA borrowers this year averaged over 700. FHA is no longer helping low income borrowers; it is supporting a tattered mortgage market that has tightened so dramatically to the point of excluding many credit-worthy borrowers. Now it is going to support even higher cost markets? How exactly is that decreasing the government's role in the mortgage market?

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