FHA Reform: A Safe Harbor in Times of Trouble

By Racy Haddad Gordon

Over the past 72 years HUD's Federal Housing Administration (FHA) has been a major player in the mortgage industry game. In fact, over 34 million Americans became homeowners at no cost to taxpayers. In recent times, however, the mortgage industry began to change due to demands from the average American desiring to buy a home without the traditional "qualifying requirements" utilized by conservative lenders. In the midst of this change and in the eye of ever-increasing mortgage products, some of which carry high risk to borrowers, FHA stayed the same. The result is that many homebuyers wishing to go the non-traditional route when qualifying or financing a home, had no option but to commit to high cost, high risk mortgages. As a result, the void left by FHA has been filled by high cost loans whose volume has grown from $332 billion in 2003 to $650 billion in 2005.

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Although many of the homebuyers who opted for these loans thought they could perform under the terms of these agreements, the fact is they couldn't. In fact, thousands of hard working Americans found themselves enticed under teaser terms of exotic loan products, many of which contain escalating interest rates, balloon payments and prepayment penalties. The result has been a turbulent sea of panic as credit-worthy, hardworking homeowners have struggled to stay afloat.

As of September 2007, the Mortgage Bankers Association confirmed what sent stock markets on a roller coaster in August 2007; a record number of homeowners received foreclosure notices in their mailboxes this past spring and millions more were late making their monthly payments. For the third quarter in a row the number of homes entering foreclosure rose and from April to May of 2007 0.65% of the 44 million homes surveyed by the Mortgage Bankers Association entered foreclosure. This rate is quickly approaching the percentage of homes in foreclosure during the 2002 recession.

However, unlike the recession in 2002, when job losses triggered foreclosure, this time it is homeowners struggling to make their payments as mortgage interest rates reset from low teaser rates to double or triple. As delinquencies rise, the subprime lending market has been the hardest hit. For all types of subprime product, 14.82% were delinquent, an increase of more than three percentage points from the same period one year ago. Subprime borrowers with adjustable rate mortgages have had the most difficult time making their monthly home loan payments; 16.95% of them were late, nearly five percentage points more than a year ago.

In this dark sea of turmoil faced by record numbers of American homeowners, the good news is a safe harbor is in sight for many. President George W. Bush has announced that HUD's Federal Housing Administration (FHA) will help an estimated 240,000 families avoid foreclosure by enhancing its refinancing program. The safe harbor in sight? The FHASecure Plan.

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The FHASecure Plan will allow families with strong credit histories who had been making timely mortgage payments before their loans reset, but are now in default, to qualify for refinancing under FHASecure. Additionally, FHA will implement risk-based premiums that match a borrower's credit profile with the mortgage insurance premium they pay. Example: Riskier borrowers pay more. This risk-based pricing became effective on January 1, 2008.

The combination of FHASecure and risk-based premium pricing will permit FHA to return to the role it was designed to play, bringing stability to the real estate market by helping break today's cycle of foreclosures and price depreciation. It will also create much needed liquidity in the non-constricted market.

The FHASecure program will utilize the same safe guidelines as the FHA's existing mortgage insurance program without affecting FHA's financial health. Eligible homeowners will be required to meet strict underwriting criteria and pay mortgage insurance premiums. The risk-based structure will expand FHA's reach to underserved borrowers and first time homebuyers who have been lured into exotic mortgages. This move to risk-based premiums ensures that FHA remains on solid ground as a self-financed agency for the long haul.

FHASecure, like all FHA products, will be underwritten to ensure that borrowers have the ability to repay the loan. These loans will require escrow for taxes and insurance and will continue to offer unprecedented foreclosure prevention assistance. The FHA has never allowed prepayment penalties and under FHASecure they will hold to that policy.

To qualify for FHASecure, eligible homeowners must meet the following five criteria:

(1) A history of on-time mortgage payments before the borrower's teaser rates expired and their loans reset;
(2) Borrowers must have 3% cash or equity in the home;
(3) Borrower's interest rates must have or will reset between June 2005-December 2009;
(4) Borrowers must have a sustained history of employment; and
(5) Borrowers must have sufficient income to make the mortgage payment.

For Americans meeting the FHASecure criteria it appears that just as they thought they would be forced to bail out, a safe harbor is in sight. According to Assistant Secretary for Housing-FHA Commissioner Brian Montgomery, "FHASecure is designed for families who are good borrowers but were steered into high-cost loans with teaser rates. These homeowners, many of whom are minorities, need a safe affordable mortgage product that will help build wealth." With that said, it appears that the American Dream is still in sight!

Author, Racy Haddad Gordon is an attorney with the law firm of Spain Hastings Ward Carey & Chambers. This article is in no way deemed a legal opinion and is not intended as an offer of legal advice. For further information on the FHASecure Plan contact the U.S. Department of Housing and Urban Development, Washington, D.C.

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