Obama Cutting FHA Cost Boosts First-Time Buyers, Builders

By Alexis Leondis and Clea Benson

January 8, 2015

A quarter of a million Americans who have been shut out of the housing recovery may be able to get a mortgage now that President Barack Obama has cut the cost to insure their loans.

Obama's plan, which was announced yesterday, will provide a jolt to homeownership for borrowers with lower credit scores by reducing the premiums they pay on Federal Housing Administration mortgages, said Brian Chappelle, a partner at consulting firm Potomac Partners LLC in Washington and a former FHA official. The Standard & Poor's Supercomposite Homebuilding Index rose 4.1 percent on the expectation of more sales of starter homes.

"It lowers the cost of homeownership, which translates into more borrowers being able to qualify," Chappelle said. "It's going to give a shot in the arm to the industry."

First-time buyers are struggling to get mortgages in a time of tight credit and slow wage growth, stymieing the housing rebound. They also haven't had as much access to FHA loans, which are meant for lower-income borrowers, after the agency raised premiums to offset losses caused by defaults during the housing crash starting in 2008.

Obama, who is scheduled to give a speech in Phoenix today, will reduce the annual FHA fees to 0.85 percent of the loan balance from 1.35 percent at the end of the month. The typical first-time homebuyer will save about $900 in their annual mortgage payment, according to the FHA.

Homebuilders Rise

"It's something we felt was too high and has been increased too much," said Larry Seay, chief financial officer of Meritage Homes Corp., based in Scottsdale, Arizona. "We're very happy to see that."

Shares of homebuilder MDC Holdings Inc. (MDC) jumped 5.6 percent, the most since November 2013, and KB Home rose 5.3 percent.

Homebuilders likely will focus more on starter homes, especially in outlying areas where land is relatively cheap, if first-time buyers have better access to credit, said Robert Curran, a managing director at Fitch Ratings in New York.

First-time purchasers accounted for about 33 percent of buying in 2014, the lowest share since 1987, according to a survey from the National Association of Realtors released in November. The FHA estimates that as many as 250,000 such Americans will enter the market over the next three years after the premium reductions.

Lower Payments

"We're extremely concerned about why housing still isn't picking up," said David Stevens, president of the Mortgage Bankers Association and FHA commissioner from 2009 to 2011. "There's no question that if there were a drop in premiums, that would give at minimum a psychological boost to Realtors, mortgage bankers, and probably a sizable number of homebuyers who are sitting on the fence."

Annual premiums, which are generally paid every month for the life of the loan, are included when tallying borrowers' debt-to-income ratio. A lower premium will help borrowers who had previously exceeded the 43 percent FHA limit, according to Chappelle.

FHA estimates the lower premium would translate into a $900 reduction in annual mortgage payments, assuming a balance larger than $100,000. Jay McCanless, an analyst at Sterne Agee & Leach, said the savings would be about $25 a month for balances of $100,000, and would have a negligible impact on housing demand.

Fannie Mae

Lower interest rates for FHA loans, combined with reduced premiums, means borrowers with low credit scores will be more likely to use FHA loans than Fannie Mae or Freddie Mac's 5-percent down program, said Rich Green, a sales manager at Presidential Bank in Bethesda, Maryland. Borrowers who have scores from 620 to 659 are charged annual premiums of 1.69 percent for a $300,000 loan from the two government-controlled companies, Green said.

The mortgage companies' new 3-percent down programs will also lose borrowers to FHA. Those with scores from 660 to 679 would pay 1.48 percent on a $300,000 loan compared with 0.85 percent through FHA, which translates into savings of $157 a month, according to Green.

While the premium cuts will help less creditworthy borrowers, they aren't in line with the Obama administration's goal of attracting more private capital to the mortgage market, said Michael Zimmerman, senior vice president for investor relations at MGIC Investment Corp. (MTG)

Mortgage Insurers

"It is consistent with trying to expand access to credit," Zimmerman said. "It just doesn't seem consistent with having private capital take more risk in the mortgage sector."

Shares of mortgage insurers declined amid concerns that the FHA price cuts would reduce the companies' sales. Essent Group Ltd. fell 7 percent, NMI Holdings Inc. lost 4.5 percent and Radian Group Inc. (RDN) slid 4.1 percent. MGIC slipped 2.8 percent.

Higher premiums have helped trigger a decline in FHA loan volume, which plummeted 19 percent in the nine months ending June 30 compared with a year earlier. The FHA had a 30 percent share of the mortgage insurance market in the third quarter of last year, down from about 69 percent in 2009, according to data from Inside Mortgage Finance.

NAR estimated total existing home sales to be about 4.94 million in 2014, a 3 percent decline from 2013.

Republicans in Congress lashed out at Obama's decision to cut premiums. Bob Corker, a Tennessee Republican who sits on the Senate Banking Committee, said it was "bad news for taxpayers" and "yet another irresponsible, head-scratching decision from the administration in regards to our nation's housing finance system."

Borrowers could end up defaulting, affecting the health of the FHA insurance fund, said Mark Calabria, director of financial regulation studies at the Cato Institute in Washington.

Julian Castro

"This sounds like a move in the wrong direction," said Calabria. "FHA has a portfolio of poor quality loans. This will end up costing the taxpayer considerably."

Housing and Urban Development Secretary Julian Castro, who is scheduled to accompany Obama to Phoenix, said yesterday the fee cut would have a "marginal" impact on the insurance fund.

The agency is required to keep enough cash on hand to cover all projected losses in its $1.1 trillion portfolio. The insurance fund needed a $1.7 billion draw from the Treasury Department last year, the first in its history. The fund posted its first positive balance in two years in fiscal 2014.

FHA borrowers account for about 10 percent of the buyers of the 2,705 units in homebuilder Meritage's backlog, down from about 40 percent of the company's total in 2011, before the insurance premiums rose and FHA loan limits were reduced, according to Seay. While Meritage sells mostly to move-up buyers, making more financing available to first-time buyers is important to the overall market health, he said.

“Most housing recoveries are based on starting at the bottom with first-time buyers and that provides a little more liquidity for move-up buyers,” he said.