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Republicans Aim to Raise FHA Down Payment Requirement

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Posted 5/25/2011 5:07 PM

The Republican led House Financial Services Committee has drafted legislation that would, among other things, **raise the FHA down-payment requirement to 5 percent and prohibit borrowers from financing their closing costs**.

The draft legislation, **"FHA-Rural Regulatory Improvement Act of 2011"**, was discussed today in a House Subcommitte hearing entitled "Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single-and Multi-Family Mortgage Markets".

In a formal release, the House Financial Services Committee's Republican Chairman Spencer Bachus touted the bill as a coming at an important time in history, "This hearing and legislative proposal come at a pivotal moment, as the Committee debates the future of the mortgage finance system, and in particular, government guarantee programs that could expose taxpayers to significant losses."

Industry advocates were quick to respond to the proposal as a move in the wrong direction. Michael Berman, Chairman of the Mortgage Bankers Asssociation, explained that down-payments are not the best indicator of payment default. Berman said, "Recently, policymakers have focused on required minimum down-payments as a measure of what factors are necessary to create sound lending practices. **While down-payment certainly impacts default risk, other compensating factors, particularly full documentation of conservative loan products, are more influential mitigating factors."**

Berman went on to share the MBA's opinion on the matter, saying, "The current minimum down-payment of 3.5 percent for borrowers with credit scores of 580 or above and 10 percent for borrowers with credit scores of 579 and below permits borrowers to have appropriate "skin in the game" while providing credit-worthy homebuyers with an option for entering the purchase market. Maintaining the existing minimum down-payment requirements, while requiring strong underwriting standards, such as full documentation and income verification, allows borrowers to responsibly become, and stay, homeowners."

The MBA isn't the only industry group to oppose the down-payment hike. Ron Phillips, President of the National Association of Realtors, shared similar sentiments in his prepared remarks. "NAR strongly opposes increasing the down-payment for FHA. The correlation between down-payment and loan performance is significantly less important than the linkage to strong underwriting, which FHA continues to have. FHA's foreclosure rate remains less than conventional mortgages, so **we don't believe changes to the down-payment would do anything but disenfranchise many creditworthy homebuyers".**

Not all feelings were mutual though. The Cato Institute, a D.C. think tank devoted to limiting government participation in free markets, believes a combination of poor credit history and low down-payment requirements have resulted in "tremendous losses" for private mortgage investors and the FHA. In its prepared testimony Cato said, "**Given the relatively "safe" features of an FHA loan, we do not have to guess about loan characteristics driving the borrower into default. We know it is equity and credit history that drives losses."**

Cato outlined a variety of FHA program reforms it believes must be implemented immediately to ensure taxpayers are exposed to minimal risk. These reforms include:

- Immediately require a 5 percent cash down-payment on the part of the borrower.
- Require FHA to allow only reasonable debt-to-income ratios.
- Restrict borrower eligibility to a credit history that is equivalent to no worse than a 600 FICO score.
- Require pre-purchase counseling for borrowers with a credit history that is equivalent to a FICO score between 600 and 680.
- **Require a 10 percent down-payment, immediately, for borrowers with a credit history equivalent to below a 680 FICO score.**
- Borrower eligibility should also be limited to borrowers whose incomes do not exceed 115 percent of median area income, so as to mirror the requirements of section 502(h)(2), as amended, of the Housing Act of 1949.

Besides raising the down-payment requirement, the proposed legislation would also cement the reduction of current "high-cost" loan limits. The maximum loan limits for Fannie Mae, Freddie Mac, and FHA are currently $417,000 with a temporary limit of up to $729,750 for one-unit properties in high-cost areas. The temporary high-cost area limit was first set in the Economic Stimulus Act of 2008, and was extended in subsequent legislation. It expires on September 30, 2011. Without the extension, the high-cost loan limit ceiling would revert back to the limits established under the Housing and Economic Reform Act (HERA), a maximum of $625,500 in high-cost areas.

The Obama administration already stated in its white paper that **it will not support another extension of the higher loan limits, but the MBA believes the higher limits should be maintained until the housing market stabilizes** and the private market shows more signs that demand has returned. MBA urged such legislation to be enacted well before October 1, 2011, in order to avoid certain market disruptions that will, because of rate locks, occur within 90 days of the current limits expiring. The National Association of Home Builders echoed that perspective.

NAHB First Vice Chairman Barry Rutenberg, a home builder from Gainesville, Fla., told the House Financial Services Subcommittee, "Counties across the country would see their loan limit reduced by tens of thousands of dollars, placing further downward pressure on home prices and impairing the ability of borrowers to use FHA-insured mortgages to purchase new homes,"

To keep FHA, Fannie Mae and Freddie Mac loan limits at their current levels, NAHB called on Congress to support H.R. 1754, the Preserving Equal Access to Mortgage Finance Programs Act, a bipartisan measure sponsored by Reps. Gary Miller (R-Calif.) and Brad Sherman (D-Calif.).

The draft legislative proposal will require a full Committee vote before it is formally introduced to be voted on by the entire house. Such measures would not be expected to pass the Senate.

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