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FHA Loans May Become More Competitive, Cont.'d

This is the conclusion of yesterday's article on the proposed changes to government-sponsored FHA loans.

Another limiting factor is that the FHA is restricted to making loans up to 85 percent of the government-sponsored enterprise conforming loan limits. With the current loan limit at $417,000, FHA loans have continued to be popular in states like Ohio, Indiana, and Texas – areas that escaped the astronomical price inflation of the housing boom. Yet in areas like the Northeast, Florida, and California FHA loans make up a miniscule portion of home loans as the median home price often sits tens or hundreds of dollars above the conforming loan limit.

New legislation sponsored by Senators Chris Dodd (D-Conn.) and Mel Martinez (R-Fla.) seeking to lower down payment requirements and increase lending limits is currently under debate in the Senate Banking Committee. Specifically, the bill will propose supplanting the 3 percent down payment requirement with a 1.5 percent "cash down" payment, consisting of down payment funds, closing costs or other lending fees.

The House passed an FHA loan-reform bill earlier this year, authorizing the agency to insure loans with no down payment at all, but that amount of risk is not likely to pass in the Senate bill. Many senators, including Senate Banking Committee ranking member Richard Shelby (R-Ala.), have criticized the lowered standards.

"One lesson learned from the current pattern of defaults and delinquencies in the sub-prime market is that those borrowers with little or no equity in their home will be the most likely to fail," Shelby said at a Committee hearing last month.

The Government Accountability Office (GAO) also voiced similar concerns in a recent report to Congress. Said a GAO spokesman, "Because of the risks and uncertainties, we continue to believe a prudent way to introduce a zero-down product would be to limit its initial availability such as through a pilot program."

In its defense however, the FHA has a good track record of keeping borrowers in their loans. The agency's loss mitigation program helped save 78,000 homeowners from foreclosure in 2004 and by 2006, 90 percent had still been able to hold on to their homes.

"Because we're the government, we require the lenders to work with the borrowers to allow people to stay in their homes," a HUD spokesman said.

While the House legislation proposed raising the FHA loan limit to 100 percent of the conforming loan limit, the Dodd-Martinez bill is also likely to stipulate the use maximum loan limits in high-cost areas and the use of median home sales prices as the limit in other areas.

The bill is still be debated in the Senate Committee but is likely to see quick action as the subprime market continues to deteriorate.

"To the extent that product choices will be eliminated in the marketplace, there is a need for additional options," said Steve O'Connor, senior vice president for policy at the Mortgage Bankers Association. "And the FHA has proved a very safe and reliable choice for consumers."

If the bill passes, you may be able turn to FHA loans as a viable option to subprime lending, even in the priciest areas of the country!

