SECONDARY MARKETING EXECUTIVE®

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The New Dawn Of FHA Financing: What You Need To Know

Many lenders will be surprised to discover the labor-intensive process involved here.

By Shelley Barth

The gap created last year by the precipitous slide in private subprime lending is being partially filled by the Federal Housing Administration (FHA), an agency within the U.S. Department of Housing and Urban Development (HUD) that was established in 1934. In its nearly 75-year existence, the agency has insured over 34 million properties and has a current portfolio that includes over 4.8 million insured single-family mortgages and over 13,000 insured multifamily projects.

The FHA is the single largest insurer of mortgages in the world. However, FHA lending melted in recent years, falling from a 19% market share of originations in 1996 to only 6% in 2005, with almost the entire decline occurring since 2001.

Yet, today, FHA-insurable financing is having a resurgence, driven in large part by the battering of private subprime financing last year, the result of disastrous loan performance in that sector.

With new government programs like FHASecure, the HUD agency's insured refinancing activity already has increased 125% in just the past year and is expected to increase even more in 2008 as homeowners examine their mortgage options.

As publicity increases, ever-growing numbers of subprime borrowers realize that they have a choice and are turning to FHA for assistance. Not surprisingly, there has been a noticeable increase among subprime lenders who are looking to get into FHA lending.

To date, there have been many industry training sessions that draw standing-room-only audiences. Attendees are enthusiastic about the prospect of a new financing outlet and typically request additional courses on using their existing lending technology to make these government-insured loans.

FHA also is involved in the reverse mortgage sector, where even greater technology and related expertise is required. Issues surrounding the timing of Home Equity Conversion Mortgages (HECMs) loan terminations and new secondary market securitizations (through Ginnie Mae) have arisen lately.

Late last year, Ginnie Mae made its first HECM mortgage-backed security (HMBS), which will allow approved issuers to securitize and sell FHA-insured reverse mortgages in the form of a Ginnie Mae security. The HMBS will increase liquidity by providing capital market funding sources to primary market HECM lenders, broadening distribution channels for these loans and expanding the investor base for the product.

First-time entrants

Many lenders are exploring FHA lending for the first time, while others - already established in the government lending market - expect to double their volumes in the upcoming year.

Some have held back, however, after hearing horror stories of complex calculations and all the associated paperwork they bring. Gradually, though, they are attempting to overcome their reluctance and appreciate the advantages of this funding source.

But, just as it is critical for any lender to have software that can support its evolving business processes, it is particularly important to have the right IT to meet tougher, and in many cases, more arcane, government stipulations.

Lenders need a loan origination system (LOS) that can track and monitor process variations and that can be customized "in-house" using business rules that are easy to write and implement - one that is foolproof and leaves no room for "outlaw" decisions.

An automated product and pricing engine eliminates much of that risk by presenting users with only the loan programs that a specific borrower qualifies for, based on the lenders' business rules.

Shelley Barth is senior vice president of professional consulting services and customer service support for MortgageFlex Systems, Jacksonville, Fla. She can be reached at sbarth@mortgageflex.com.

Especially valuable in FHA lending, a business rules management system drives process compliance via workflow and allows lenders to change product and pricing requirements on an as-needed basis. Automated decisioning reviews credit-associated risk and incorporates results into the business logic.

Last summer, the Bush Administration proffered new FHA expansion and modernization proposals that would, among other things, help borrowers who have good credit but may not have made all of their payments on time because of resetting interest rates. The aim is to help approximately 240,000 borrowers in fiscal year 2008.

Most lenders have been waiting for the legislation to be finalized before adapting their LOSs. According to a recent Mortgage Bankers Association statement, "members have indicated that it will take a minimum of four to six months after finalization of the proposal to update their technology systems."

The FHA Modernization Act of 2007, approved by the U.S. Senate in mid-December, would:

■ Lower down-payment requirements for low- to middle-income home buyers,

■ Allow the FHA to insure larger loans in higher-cost areas, and

■ Give the FHA more pricing flexibility.

Over 300 lenders already have signed up to participate in the new FHASecure program, "designed to help subprime borrowers refinance into safe and more affordable FHA mortgages," according to the agency, which indicates that the program is intended for refinancing of any borrower - current or delinquent. (Refinancings of non-FHA borrowers during the first 11 months of fiscal year 2007 - ending this past August - nearly doubled to $16.6 billion, compared to fiscal year 2006.)

By the end of 2007, more than 53,000 borrowers had refinanced their (privately funded) subprime home loans with FHASecure. The program may even permit refinancing of certain delinquent borrowers, with interest-only (IO) and payment-option adjustable-rate mortgages (ARMs). One condition is that the delinquency on an IO or option ARM must be the result of an interest rate reset or the full amortization of the mortgage.

FHA could be a vehicle to provide lower-priced and more sustainable mortgage options for some borrowers who are considering or struggling to maintain higher-priced subprime loans.

Compliance requirements

While this new legislation is good news for many borrowers, it represents a potential morass of complexities for lenders. Keeping systems and processes current and compliant makes a typically never-ending battle even more difficult.

Compliance with any new FHA guidelines, including the Modernization Act, should not be a problem with all of the current FHA process, documentation, decisioning and loan limits already programmed into the better LOSs. They allow, for example, more work to be done on the up-front qualification side to determine whether a borrower is appropriately placed in an FHA loan or not. Automation is a really big advantage for any lender without a government loan specialist in-house.

As the renewed FHA financing role evolves, many lenders will be learning - or re-learning - how to originate these loans. Shifting from subprime lending, which requires very little documentation, to FHA, which is labor intensive, is a major culture change for these companies.

They may experience culture shock because of different calculations that are required for purchases, refinances and streamlined refinances. Many experienced lenders do not understand how to calculate mortgage insurance (MI) refunds when MI is no longer required. The right origination system acknowledges the latest FHA requirements and automatically performs calculations and defaults fee allowances for FHA-allowable closing costs.

A government lending program drives compliance and leaves little to no room for mistakes without penalties. It is extremely important for lenders to stay current with compliance issues. Lenders actually are relieved to learn that new LOS technology makes it far easier to underwrite these loans today than in the past.

Training is crucial

LOS provider training is crucial for lenders to understand what technology can do for them. Requirements like the Mortgage Credit Analysis Worksheet and the Maximum Mortgage Worksheets can give lenders fits - requiring a special understanding of creating a loan based on the purchase price and estimated closing costs, then building some of those calculations into documentation.

Another major change for lenders is that FHA lending decisions will be more credit score, risk-based driven. Other "devils" lurking in the details are:

■ Calculating down-payment percentages,

■ Determining eligibility for the mortgage insurance premiums based on an applicant's credit score (FICO),

■ Minimum equity requirements for cash-out refinance loans, and

■ Up-front premiums for streamlined refinancings of an existing FHA loan for which a case number was assigned prior to Jan. 1, 2008, and for first-time home buyers (when counseling is involved). SME