FHA Refinance Program Termination Act, H.R. 830

Bill Provisions. The bill would terminate authority for FHA to guarantee new single family refinance loans under its FHA Refinance program, which provides refinancings in conjunction with a reduction in principal by the existing first mortgage holder of at least 10%. The program uses FHA loan guarantee authority, but expected losses in excess of normal FHA losses are covered by loss funds set aside from EESA (TARP) funds. The bill also terminates FHA's mortgagee letter issued in conjunction with this program, and prohibits FHA from issuing a "substantially similar" mortgagee letter in the future.

FHA Short Refinance Program. The program was rolled out by the Obama Administration in October, 2010, and expires at the end of 2012. It is designed to offer incentives for holders of existing single family loans where the borrower is "underwater" (ie., the loan amount exceeds the current property value) to reduce the outstanding principal balance of the underwater portion of the loan, in conjunction with a FHA refinancing of the remaining loan balance. The homeowner must be current on the existing loan, and other FHA standards apply (eg., LTV not to exceed 97.75%, standard FHA mortgage premiums to be charged, normal FHA debt to income ratios and loan documentation standards, home must be owner occupied). The existing lender must write off at least 10% of the current outstanding loan balance. Subordinate lien debt is permitted (including a re-subordination of the portion of the prior first lien loan not forgiven), provided the combined LTV does exceed 115% of the current property value. Borrowers with a HAMP loan modification are eligible for such a loan.

The program is designed to address concerns that other loan modification and refinancing programs may address payment affordability problems, but do not resolve underlying problems caused by mortgage loans being underwater. According to a December 13, 2010 release by CoreLogic, a leading provider of mortgage data, 10.8 million, or 22.5 percent, of all residential properties with mortgages were in negative equity at the end of the 3rd quarter, 2010. Mark Fleming, CoreLogic's Chief Economist, noted that *"Negative equity is a primary factor holding back the housing market and the broader economy."*

Some research has shown that default and foreclosure levels increase when loan to value (LTV) levels exceed 115% of LTV. This is because homeowners who are struggling to make payments on their mortgage are less motivated to keep making such payments if they are significantly underwater and don't have an expectation that their home will appreciate any time soon up to the loan amount.

Underwater mortgages also lock homeowners in their home, preventing them from selling the home and being able to move without bringing substantial cash resources to the closing table.

Use of TARP Funds/Costs. Loans are FHA-guaranteed loans, and FHA charges standard fees and bears most of losses incurred on the loans. However, since these loans are somewhat riskier than normal FHA loans, TARP funds are set aside to cover additional risk, and avoid an impact on FHA capital reserves. Chairman Bachus' 2/24 press release claims the price tag for the program is $8.12 billion. But this is only the loan loss reserve amount Treasury has allocated for this purpose. In practice, funds will only be expended if and to the extent the program is used (and if not used, funds go back to taxpayers, per the Democratic amendment to Dodd-Frank). It is possible that the program will cost as much as $8 billion, and it is possible that there will be very limited loan use – but both can't be true at the same time.

Projected Program Use. As of the beginning of February, 2011, there were only 245 loan applications, and only 45 loans closed to date. This sparse use to date is due various reasons, including the fact that it has only been operational for a few months, that lender/servicers have had to update their systems in order to be ready to process loans, and that participation depends on their willingness to make meaningful principal reductions on existing loans. However, a February 28, 2011 American Banker article notes that Wells Fargo & Co. and Ally Financial, Inc. (formerly GMAC, Inc.) are poised to roll out pilots that would let underwater borrowers refinance into this FHA short refi program. The article also included a quote from a managing member of a firm specializing in distressed mortgage loan portfolios, who said that "the program is starting to gain traction because it allows an exit strategy for whole loan investors."