Regional Perspective

Housing market conditions remained strong through the fourth quarter in most areas of the country. The substantial increases in residential construction in 1994 led to shortages of skilled labor in a number of the major markets in the Southeast and Southwest regions and in Arizona and Nevada.

Multifamily activity and rental markets boomed in 1994 except in New England, New York/New Jersey, and the Mid-Atlantic. All other regions reported significant increases in apartment construction. The number of multifamily units permitted more than doubled in 11 States. The second half of the year was especially strong in the Midwest, Great Plains, Rocky Mountain, and Pacific regions. The Southeast and Southwest continued to show strong activity for most of the year, but had slowed by the end of the year.

HUD economists report that amenity-rich projects with high rents comprise a significant part of the new rental housing in the Southeast, Southwest, Rocky Mountain, and Northwest regions. Large, two-bedroom, two-bath units with washers and dryers, extensive recreation facilities, and garages are typical of this new housing.

Single-family home construction and sales were above 1993 levels in much of the country. Although rising mortgage interest rates caused slowdowns in sales in the second half of the year, the increased popularity of adjustable-rate mortgages (ARMs) has mitigated the impact. By year-end, ARMs were accounting for 90 percent of the loans in some markets of the Rocky Mountain region. All the other regions reported the use of ARMs at year-end made up 20 to 50 percent of the market. Builders have cut back on construction in response to growing inventories in some markets, but there is no sign yet of widespread use of concessions or buydowns.

FHA Serves the Underserved

The Administration, Congress, and members of the housing industry are once again considering the future of HUD's Federal Housing Administration (FHA) single-family mortgage insurance programs.[1] Among the options being discussed are restructuring FHA so that it can perform more efficiently, determining whether FHA is still needed in light of recent affordability initiatives in the private market, and privatizing FHA. HUD has proposed restructuring FHA as a Government-owned corporation under the direction of the Secretary of HUD.

In this issue, *U.S. Housing Market Conditions* examines the role that FHA currently plays in the market for home mortgage finance. The report uses newly available data on mortgage lending in 1993 that lenders submitted to the Federal Government under the Home Mortgage Disclosure Act (HMDA).[2] Because only lenders making loans in metropolitan areas are required to report under HMDA, lending activity for nonmetropolitan areas is not available from this source. Metropolitan areas account for over 85percent of FHA-insured mortgages.

The HMDA data and other information presented in this report show that FHA single-family insurance plays a valuable role in today's mortgage market. Borrowers and lenders use FHA insurance as the instrument of choice to extend home mortgage credit to underserved groups and markets.

FHA Single-Family Insurance Is Alive and Well

Whether measured in terms of volume of business, market share, or profitability, FHA single-family insurance is an active and self-sustaining government business.

Table 14 in the Historical Data section shows how the number of endorsed FHA single-family insurance contracts has fluctuated since 1968. Table 16 presents similar information in terms of the dollar value of the mortgages underwritten. In terms of either mortgage insurance contracts or the value of mortgages underwritten, 1993 and 1994 were strong years for FHA. In both years, FHA insured over 1 million insurance contracts. Refinancings were important in both years, but FHA insured 686,487 purchase mortgages in 1994, the third highest number in FHA's history.

Since 1980, FHA has insured between 6 and 15percent of the dollar volume of all mortgages originated (based on data from Table 16). A lender will generally not require mortgage insurance if borrowers have sufficient equity in the property to protect the lender's interests. Therefore, the ratio of FHA-insured mortgages to all insured mortgages (FHA, VA, or privately insured) provides a better sense of FHA's market share. Since 1980, FHA has insured between 19percent and 58percent of all insured mortgages (based on data from Table 14).

Three points stand out from comparing FHA and other insurers in Table 14. First, FHA's share of total insured business increased during the 1980s. FHA had a share above 50 percent between 1986 and 1991 compared with slightly over 30 percent between 1980 and 1985. Second, both FHA's volume and its share of the insured market increased during the refinancing waves of 1986 to 1987 and 1993. This most likely reflects borrower preferences for fixed-rate mortgages during periods of low interest rates. Most of FHA's underwriting involves fixed-rate mortgages as opposed to adjustable rate mortgages for which private mortgage insurers (PMIs) historically claim a higher market share than FHA. In addition, many homeowners who refinance have built enough equity to drop private mortgage insurance. In addition, FHA's market share in the 1986 to 1987 period probably benefited from the weakness in the private mortgage insurance business following heavy financial losses in the mid-1980s.

Third, FHA's market share declined after the financial reforms in 1991 that were intended to restore the financial strength of FHA's Mutual Mortgage Insurance (MMI) Fund, which also suffered losses in the 1980s. To increase FHA's capital reserves, premium charges were raised; to lower insurance claim costs, requirements for borrower equity were increased. Immediately after implementation of these measures, FHA lost some of its market share to conventional market lenders using private mortgage insurance. Its market share of all insured loans, including VA loans, fell to 36percent in 1992 but rose to 40percent in 1993 and 42percent in 1994.

Most FHA single-family insurance is underwritten for the MMI Fund. Since 1934, when FHA was established, the MMI Fund has operated on a self-sustaining basis; that is, premium collections have been sufficient to cover insurance losses and operating expenses. In the late 1980s, there was growing evidence that FHA's most recent business was not actuarially sound and that FHA had insufficient reserves to cover anticipated future losses. In 1990 Congress amended the FHA statute to raise the premium and increase the equity requirement as discussed in the preceding paragraph. At the same time, Congress set a capital reserve target for the year 2000 of 2percent of insurance in force. The most recent independent audit of the MMI Fund estimates that it will have a capital reserve of 3.4percent in the year 2000, more than one and one-half times the target rate.

Despite the high level of single-family underwriting and the financial soundness of the MMI Fund, problems still exist with HUD's FHA single-family insurance program. Since FHA raised its mortgage insurance premiums in 1991, the proportion of its new business consisting of the riskier, high loan-to-value ratio loans has increased steadily. In 1991 56percent of the loans FHA insured had loan-to-value ratios over 95percent; by 1994 that proportion had risen to 61percent. [3] During the same period, new FHA business with loan-to-value ratios below 90percent had dropped from 21 to 16percent. FHA lowered its premium charges in 1994, making it more competitive with private mortgage insurance. Although FHA's premiums are still above their pre-1991 level, this change may lead to a better balance between high and low loan-to-value ratio mortgages.

Also HUD's ability to operate the FHA single-family insurance program to best serve the needs of the mortgage market is hindered by a lack of flexibility. Because the essential features of all the FHA insurance programs are prescribed in legislation, HUD cannot easily modify its programs to meet the evolving needs of the market. Moreover, HUD's ability to marshall resources to deal with particular problems is limited by hiring and contracting rules designed for Government activities of a nonbusiness type.

FHA and the Underserved

From a Federal Government perspective, the importance of FHA single-family insurance rests more on whom FHA serves than on how many FHA serves. Using HMDA and other data, this section shows that lenders use FHA insurance to provide housing credit to first-time homebuyers, minorities, and low-income families, and to homebuyers purchasing in central cities and in minority or low-income neighborhoods.

FHA particularly stands out as an insurer of low downpayment mortgages for first-time homebuyers. In 1993 roughly two-thirds of FHA's home purchase mortgages were for first-time homebuyers and about 85 percent of its purchase mortgages had loan-to-value ratios over 90 percent.

Table A presents 1993 HMDA data on how frequently borrowers and lenders use FHA insurance for groups and areas that are considered to have limited access to mortgage credit. The term "underserved" is often applied to these groups and areas.

The following qualifications apply to the data reported in Tables A through C. Only mortgages used to purchase a home are included; refinancings are not included. As noted earlier, HMDA data cover only metropolitan areas. Mortgages guaranteed by the Department of Veterans Affairs or insured by the Farmers Home Administration (FmHA) are excluded from these comparisons because these programs serve specialized markets. Jumbo loans, that is, mortgages exceeding $203,150, are also omitted.[4]

The first column of Table A shows the percentages of all loans, FHA and conventional, that are made to these underserved groups and areas. The second column shows the percentage of FHA loans, and the last column indicates the number of FHA loans made in 1993. The percentages in Table A add up to more than 100percent because of overlap among the groups and areas.

Blacks and Hispanics use FHA insurance at a rate approximately twice their share of all purchase mortgage originations. Similarly, FHA insurance is chosen disproportionately by lower income families

Table A. Metropolitan Home Purchase Loans in 1993

	Distribution of Home Purchase Loans		Number of FHA Loans
	FHA Plus Conforming Conventional	FHA Only	
All loans	100%	100%	487,896
Blacks	5%	11%	52,658
Hispanics	6%	10%	50,057
Less than 60% of median income	12%	18%	84,295
Less than 80% of median income	28%	42%	198,982
In central cities	40%	46%	226,409
In low-income census tracts	11%	17%	82,701
In minority census tracts	15%	23%	110,525

Source: HUD/Office of Policy Development and Research analysis of 1993 HMDA data.

and families choosing to purchase homes in central cities or in low- income or minority census tracts.[5] For purposes of these comparisons, low-income census tracts are census tracts where median family income is less than 80percent of median family income for the metropolitan area; and minority census tracts are census tracts where at least 30 percent of the population are in a minority group.

FHA Versus Conventional Financing

The principal alternatives to an FHA-insured mortgage are an uninsured conventional mortgage, typically requiring a loan-to-value ratio of 80percent or less, or a privately insured conventional mortgage.[6] This section examines how well conventional mortgages, both insured and uninsured, serve these same groups and areas. Lenders using FHA insurance outperform conventional sources of mortgage finance in providing home financing to underserved groups and areas, particularly to black and Hispanic homebuyers.

As reported in the previous section, two-thirds of FHA's home purchase mortgages were used by first-time homebuyers in 1993. Comparable information on conventional mortgages is available only for those conventional mortgages purchased or securitized by the two Government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. In 1993 first-time homebuyers represented 31 percent of Freddie Mac's and 24 percent of Fannie Mae's business. In fact, FHA helped roughly the same number of first-time homebuyers as the GSEs (398,400 compared with a combined total of 404,300).[7]

Table B compares the use of FHA-insured mortgages or conventional mortgages by underserved groups and areas. The FHA column in Table B is the same as the FHA percentage column in Table A. Because FHA's local maximum mortgage limits focus FHA business on the lower half of the market, Table B limits its analysis of conventional financing to those mortgages that would be eligible for FHA insurance, that is, the "FHA-eligible" portion of the conforming conventional market.[8] This restriction makes the comparison fairer to conventional financing because higher valued mortgages are less likely to fit into any of the "underserved" categories.

Table B. Percentage Distribution of Metropolitan Home Purchase FHA-Eligible Conventional Loans

	FHA	Eligible Conventional
Blacks	11%	4%
Hispanics	10%	5%
Less than 60% of median income	18%	16%
Less than 80% of median income	42%	35%
In central cities	46%	38%
In low-income census tracts	17%	13%
In minority census tracts	23%	14%

Source: HUD/Office of Policy Development and Research analysis of 1993 HMDA data.

FHA-insured mortgages are more likely to be used to provide credit for underserved groups and areas than are conventional mortgages. This statement is true for all the groups and areas identified in Table B and is particularly the case for blacks, Hispanics, and homebuyers locating in minority neighborhoods.

There are at least three possible explanations for this fact. Some lenders may specialize in serving these underserved groups and areas and these lenders may prefer FHA insurance. Alternatively, lenders who serve a broad array of borrowers and markets may tend to reserve FHA insurance for use with these underserved groups and areas. Finally, underserved borrowers may need the high loan-to-value ratios possible with FHA mortgages. In any case, FHA insurance appears to be the preferred instrument for extending credit to the underserved.

Specialized use of FHA insurance for the underserved does not mean FHA is alone in serving these groups and areas. Because of the greater volume of conventional lending, conventional mortgages also play an important role in serving these groups and areas.[9]

Table C compares market shares of FHA and conventional financing for each of these underserved groups and areas. The first column restricts the comparison, as in Table B, to mortgages that are eligible for FHA mortgage insurance. The second column gives FHA's market share for all loans less than $203,150, that is, for all conforming loans. The conventional share is always the difference between 100percent and the FHA share. For example, among blacks obtaining mortgages eligible for FHA insurance, 54percent use FHA mortgages and 46percent (100 – 54) use conventional mortgages, with or without private insurance.

In 1993 FHA insured 32percent of eligible mortgages in metropolitan areas. The remaining 68percent of the eligible mortgages were conventionally financed, with or without private insurance. FHA's share of the market for every underserved group and area is greater than one-third. In some cases, FHA's market share is only marginally greater than its overall share of the metropolitan market, but the differences become substantial once race enters the analysis. FHA's share of the market for black and Hispanic borrowers and for borrowers purchasing in minority neighborhoods is substantially greater than one-third. In fact, FHA insured over half of the eligible mortgages issued to blacks and Hispanics in metropolitan areas even though it insured only one-third of all eligible mortgages.

The pattern is the same for FHA's share of the conforming loan market with one exception. For borrowers with incomes less than 60percent of the median income, FHA's share is substantially greater than its overall share of the conforming market.

Table C. FHA Market Shares of Metropolitan Home Purch
Conforming Conventional Markets

	FHA's Share of Eligible Market	FHA's Share of Conforming Market
All loans	32%	23%
Blacks	54%	47%
Hispanics	49%	41%
Less than 60% of median income	34%	34%
Less than 80% of median income	36%	35%
In central cities	36%	28%
In low-income census tracts	39%	35%
In minority census tracts	43%	35%

Source: HUD/Office of Policy Development and Research analysis of 1993 HMDA data.

One reason for the larger share of minority borrowers is FHA's lower denial rate for minorities compared to denial rates of conventional loans. In 1993 denial rates for blacks applying for FHA mortgages was 20percent compared to 27percent for conventional loans eligible for FHA insurance. Denial rates for Hispanics applying for FHA mortgages was 14percent compared to 23percent for conventional loans eligible for FHA insurance. Denial rates for whites were substantially lower than the denial rates for blacks and Hispanics for both FHA and conventional mortgages, 10percent compared to 13percent.

Summary

FHA is an important component of today's mortgage finance system. FHA insured over 1 million mortgages in 1994, including 686,487 mortgages to purchase homes. Lenders use FHA insurance more consistently than other options to provide mortgage credit to first-time homebuyers, minorities, low-income families, and homebuyers purchasing in central cities and in minority or low-income neighborhoods. First-time homebuyers particularly make use of FHA insurance. Also, the ability of blacks and Hispanics to purchase homes seems linked in an essential way to the availability of FHA insurance.

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[1] Previous examinations include HUD's *Future Role of FHA* (1977), *The Report of the President's Commission on Housing* (1982), *President's Private Sector Survey on Cost Control: Report on Financial Asset Management* (1983), and *Privatization: Toward More Efficient Government* (1988) by the President's Commission on Privatization.

[2] Congress enacted HMDA in 1975 in response to concerns that depository institutions were not adequately serving low-income and minority neighborhoods. HMDA, as amended, requires almost all lenders to report annually their mortgage activity by borrower characteristics and census tract location so that the public can assess whether lenders are adequately serving their communities. HMDA data cover mortgages on single-family properties with one to four units and include information on applications, originations, and rejections for all depository lenders and their subsidiaries and for all mortgage companies with at least 100 or more home purchase loans in the preceding year.

[3] This estimate excludes those refinancings for which a new appraisal was not available.

[4] Mortgages larger than this amount, called the conforming limit, are not eligible for purchase by Fannie Mae or Freddie Mac.

[5] Separate analysis of American Housing Survey data going back, at 2-year intervals, to 1985 document the same lending patterns for FHA-insured single-family mortgages.

[6] Private mortgage insurance differs from FHA insurance in several important ways. FHA insures the entire mortgage balance; PMIs typically insure only up to a quarter of the mortgage balance. If losses exceed the insured percentage of the mortgage balance, the lender or the entity guaranteeing the mortgage-backed security must bear the additional loss. Federal Government backing for FHA-insured mortgages provides a stronger sense of security than the reserves set aside by PMIs. Most importantly, FHA mortgages generally allow higher loan-to-value ratios, making it easier for borrowers to finance a home purchase. In recent years, some PMIs have developed demonstration programs providing high loan-to-value mortgages similar to FHA's programs.

[7] The data on conventional mortgages purchased or securitized by Fannie Mae and Freddie Mac comes from information submitted to HUD by these institutions in compliance with HUD regulations.

[8] FHA cannot insure mortgages above a locally determined maximum mortgage amount. In 1993 the maximum mortgage amount varied between $67,500 and $151,725.

[9] FHA's share of the home purchase market varies substantially across metropolitan areas. The average across all metropolitan areas is 23.4percent of the conforming market, and 31.9 percent of the FHA-eligible market.