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U.S. Mortgage Backer May Need Bailout

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A year after Fannie Mae and Freddie Mac teetered, industry executives and Washington policy makers are worrying that another government mortgage giant could be the next housing domino.

Problems at the Federal Housing Administration, which guarantees mortgages with low down payments, are becoming so acute that some experts warn the agency might need a federal bailout.

Running questions about the F.H.A.'s future — underscored by interviews with policy makers, analysts and home buyers — came to the fore on Thursday on Capitol Hill. In testimony before a House subcommittee, the F.H.A. commissioner, David H. Stevens, assured lawmakers that his agency would not need a bailout and that it was managing its risks.

But he acknowledged that some 20 percent of F.H.A. loans insured last year — and as many as 24 percent of those from 2007 — faced serious problems including foreclosure, offering a preview of a forthcoming audit of the agency's finances.

"Let me simply state at the outset that based on current projections, absent any catastrophic home price decline, F.H.A. will not need to ask Congress and the American taxpayer for extraordinary assistance — we will not need a bailout," Mr. Stevens said in his testimony.

But to its critics, the F.H.A. looks like another Fannie Mae. The hearings on Thursday came on the same day that the federal agency charged with overseeing Fannie Mae and Freddie Mac provided a somber assessment of those giants' health. In the year since the government stepped in to rescue them, the companies have taken $96 billion from the Treasury, and may need more.

Since the bottom fell out of the mortgage market, the F.H.A. has assumed a crucial role in the nation's housing market. Created in 1934 to help lower-income and first-time buyers purchase homes, the agency now insures roughly 5.4 million single-family home mortgages, with a combined value of $675 billion.

In addition, these loans are bundled into mortgage-backed securities and guaranteed through the Government National Mortgage Association, known as Ginnie Mae. That means the taxpayer is responsible for paying investors who own Ginnie Mae bonds when F.H.A.-backed mortgages hit trouble.

"It appears destined for a taxpayer bailout in the next 24 to 36 months," Edward Pinto, a former Fannie Mae executive, said in testimony prepared for the hearing. Mr. Pinto, who was the chief credit officer from 1987 to 1989 for Fannie Mae, went further than most housing analysts and predicted that F.H.A. losses would more than wipe out the agency's $30 billion of cash reserves.

The issue has polarized Congress. Republicans, who led efforts to rein in Fannie Mae and Freddie Mac before those companies ran into trouble, are now seeking to bridle the F.H.A. Many Democrats insist the F.H.A. is playing a vital role in the housing market, which is only just starting to stabilize.

"F.H.A. has stepped into the void left by the private market," Representative Maxine Waters, Democrat from California, said at the hearing. "Let's be clear; without F.H.A., there would be no mortgage market right now."

That was the case for Bernadine Shimon. Like many Americans, Ms. Shimon has recently been through some rough times. She lost a house to foreclosure, declared bankruptcy, got divorced and is now a single mother, teaching high school English in a Denver suburb.

She wanted a house but no lender would touch her. The Federal Housing Administration was more obliging. With the F.H.A. insuring her mortgage, Ms. Shimon was able to buy a $134,000 fixer-upper in August.

"The government gave me another chance," she said.

The government is giving as many people as it possibly can the chance to buy a house or, if they are in financial difficulty, refinance it. The F.H.A. is insuring about 6,000 loans a day, four times the amount in 2006. Its portfolio is growing so fast that even F.H.A. backers express amazement.

For decades it was an article of faith that helping people of limited means like Ms. Shimon get a house was good for the new owner, good for the neighborhood and good for American capitalism. Then came the housing bust, which demonstrated that when lenders allowed people to buy houses they ultimately could not afford, it hurt the parties — while putting the economy itself in a tailspin.

In the aftermath of the crash, there is wide divergence on how easy, or how hard, it should be to become a homeowner. Skittish lenders are asking for 20 percent down, which few prospective borrowers have to spare. As a result, private lending has dwindled.

The government has stepped into the breach, facilitating loans with down payments as low as 3.5 percent and offering other incentives to stabilize the market. Real estate agents in some hard-hit areas say every single one of their clients is using the F.H.A.

“They’re counting their pennies, scraping up that 3.5 percent,” Bonni Malone of Prudential Americana in Las Vegas said. “Mostly they’re buying foreclosed homes from banks, although I had one client who bought from a guy that was dying. It’s turning around the market.”

While the government’s actions have helped avert full-scale economic disaster, there is growing concern that it might have doled out its favors with too generous a hand.

Many of the loans the F.H.A. insured in 2007 and last year are now turning delinquent, agency officials acknowledge. The loans made in those two years are performing “far worse” than newer loans, dragging down the whole portfolio, Mr. Stevens of the F.H.A. said in an interview.

The number of F.H.A. mortgage holders in default is 410,916, up 76 percent from a year ago, when 232,864 were in default, according to agency data.

Despite the agency’s attempt to outrun its fate by insuring ever-larger amounts of new loans to such borrowers as Ms. Shimon — the current rate is over a billion dollars a day — 7.77 percent of the portfolio is in default, up from 5.6 percent a year ago.

Barney Frank, the Massachusetts Democrat who is chairman of the House Financial Services Committee, said in an interview that the defaults were, in essence, worth it.

“I don’t think it’s a bad thing that the bad loans occurred,” he said. “It was an effort to keep prices from falling too fast. That’s a policy.”

The troubled loans are nevertheless weighing on the agency’s capital reserve fund, which has fallen to below its Congressionally mandated minimum of 2 percent, from over 6 percent two years ago.

The optimism expressed by Mr. Stevens, the F.H.A. commissioner, places him at odds not only with some outside experts but with Kenneth Donohue, the inspector general of the Housing and Urban Development Department, who is also F.H.A.’s watchdog. Mr. Donohue said the drop in reserves was “a flashing red light” that the agency was not taking seriously enough.

“It might be we’ll get ourselves out of this and that everything will be fine, but I don’t paint that rosy a picture,” Mr. Donohue said. “They’re banking on the fact that the economy will continue to improve, that the housing market will begin to sustain itself.”

He noted that if private lenders had raised their down payment requirements in the last two years, it raised the question, “what does the F.H.A. think it is doing by asking only 3.5 percent?”

Any more than that and Ms. Shimon, 45, would still be a renter. As it was, she cashed in her retirement savings account to come up with the necessary funds. She did not have enough to spare for closing costs, so her mortgage broker arranged a deal where the charges were wrapped into the loan at the cost of a higher interest rate. She cried when the deal was done.

The house was empty and trashed. Slowly, she is trying to bring it back to life. She spent the first few weeks picking up garbage in the backyard.

Is Ms. Shimon a good bet? Even she has no easy answer. Her mortgage payment, $1,100, is half of what she takes home every month. It is not easy to make ends meet. Teachers can get laid off like everyone else.

“The government,” she said, “is doing what it needed to do — taking a risk on people.”

Chaz Fullenkamp, an automotive technician in Columbus, Ohio, got an F.H.A. loan even though he was living on the financial edge. “If I got unemployed, I’d be wiped out in a month or two,” he says. Thanks to the F.H.A., however, he is better off than he used to be.

Mr. Fullenkamp used F.H.A. insurance to buy a house this spring for $179,000. The eager seller paid the closing costs and also gave Mr. Fullenkamp $2,500 in cash. He immediately applied for the $8,000 tax rebate. Even taking his down payment into account, he came out ahead.

“I knew in my heart I could not really afford the house, but they gave it to me anyway,” said Mr. Fullenkamp, 22. “I thought, ‘Wow, I’m surprised I pulled that off.’ ”

As the number of loans has soared, random quality control checks have decreased sharply, F.H.A. staff members say. Mr. Donohue, the inspector general, cited numerous examples of organized fraud in testimony to Congress earlier this year.

“They need to stop taking bad loans in the door,” he said in an interview. “They’re taking on all this volume, they have to have very active underwriting standards.”

Jack Healy contributed reporting from New York.