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FHA Hits Brakes on Housing With Budget Cuts: Mortgages

By Kathleen M. Howley - Feb 28, 2013

U.S. spending cuts scheduled to kick in tomorrow will constrain the availability of Federal Housing Administration mortgages that account for about a quarter of originations, threatening its role in the year-long housing recovery.

Department of Housing and Urban Development cuts will force staff reductions that could slow FHA loan approvals and curtail programs such as foreclosure counseling, according to HUD Secretary Shaun Donovan. If FHA lending drops by the same rate as HUD's budget, it could shave about 2 percent off U.S. home sales this year.

The so-called sequestration, $1.2 trillion in automatic reductions in federal spending, would pare $42.7 billion from non-defense federal agency budgets this year, according to government estimates. For real-estate, the impact would be magnified because FHA's market share has grown to five times its 2006 level as it expanded its role during the property bust. Since 2008, the FHA has backed more than a quarter of U.S. mortgages, according to HUD data.

"The FHA has been a critical support to the housing market, for first-time buyers and purchases of homes in general," said Mark Willis, a professor at New York University's Furman Center for Real Estate and Urban Policy and a former economist at the Federal Reserve Bank of New York. "Any decrease in the rate the FHA is able to ensure mortgages will clearly hurt housing."

Hearing Today

The Senate Banking Committee will hold a hearing today in Washington on the agency where there will be "significant discussion about raising the FHA down payment requirement," which is currently 3.5 percent, Jaret Seiberg, senior policy analyst at Washington Research Group, a unit of Guggenheim Securities LLC, wrote in a note today. They're also likely to address consequences to FHA lending "if the sequester hits on Friday or if Congress fails to fund the government beyond March 27," he wrote.

Investors in companies from builders to home-improvement retailers are dismissing the likelihood of a weakening in housing. An index of homebuilders fell 0.1 percent today at 10:45 a.m. in New York after rising 7.4 percent this year and 73 percent over the past 12 months. The median home price last month rose 12 percent from a year earlier, the biggest gain since 2005, according to the National Association of Realtors. Home sales in January increased to a 4.92 million annual rate, 43 percent above a record low two years ago.

Fed Buying

The housing recovery, engineered by the Federal Reserve's program of buying mortgage bonds to lower borrowing costs, has been successful enough that the central bank should reduce the pace of the acquisitions, Federal Reserve Bank of Dallas President Richard Fisher said yesterday. This week, the average rate for a 30-year fixed mortgages is 3.51 percent, down from 4.95 percent two years ago, according to Freddie Mac.

Still, the budget cuts will trim half a percentage point from economic growth in 2013 and cause 1 million job losses, according to the Bipartisan Policy Center in Washington.

"Across-the-board, draconian cuts will hurt the housing recovery," said Diane Swonk, chief economist at Mesirow Financial Inc. in Chicago. "Housing will still have momentum, but a lot less momentum."

The reductions will boost the unemployment rate, which was 7.9 percent in January, a quarter of a percentage point and keep it elevated for several years, Macroeconomic Advisers LLC said in a Feb. 19 report.

'Additional Burden'

"Given the still-moderate underlying pace of economic growth, this additional near-term burden on the recovery is significant," Fed Chairman Ben S. Bernanke said in congressional testimony this week. The cuts will have "effects on jobs and incomes," he said.

While deep budget cuts could bruise the real estate market, reducing federal debt will support housing demand in the long term by putting the economy on firmer ground, said Joshua Shapiro, chief U.S. economist at Maria Fiorini Ramirez Inc. in New York.

"There's no way to get around the painful and negative effects of the cutbacks we need to put our fiscal house in order," Shapiro said. "When the adjustments are happening, it's not going to feel good."

The cuts stem from a 2011 agreement to raise the debt ceiling and were intended to force Congress to reach a compromise on reducing spending. About half the reductions come from defense and half from domestic spending. The Obama administration doesn't expect to see a deal reached by tomorrow's deadline, Dan Pfeiffer, a senior White House adviser, said on a conference call with reporters on Sunday.

Softening Blow

If Congress and the White House don't act in time to avert the spending cuts, they may be able to soften the blow in coming weeks, said Mark Zandi, chief economist for Moody's Analytics Inc. in West Chester, Pennsylvania. They may agree to slow the pace of the reductions, or target them more precisely to limit the economic fallout, he said.

"We may see a more rational approach, instead of cutting across the board," Zandi said. "They may find a way to make it hurt less."

Reducing access to FHA-backed mortgages would reverse an expansion in loan availability, said NYU's Willis. The approval rate for all home-purchase mortgages rose to 61 percent in January, up from 56 percent a year earlier, according to Pleasanton, California-based Ellie Mae.

Lower Revenues

Fewer FHA loan guarantees also means lower revenue for the agency. In November, an independent audit of the FHA showed it was on shaky financial ground and could require a cash infusion from the government. A reduction in lending volume means the agency forgoes upfront fees of 1.75 percent of balances that FHA Commissioner Carol Galante has said are key to improving its finances.

"If we are going to see improvement in the housing market, we need to be able to accommodate new buyers," Willis said. "For some first-time buyers, this is the only kind of mortgage they can get."

Growth in home sales and prices underpin the consumer spending that accounts for about 70 percent of the economy. Household purchases rose at a 2.1 percent annual rate in the fourth quarter after increasing at a 1.6 percent pace in the previous three months, the Commerce Department said today.

"Increases in home prices have a very big effect on consumers and households and is certainly behind the recent strong growth in consumer spending," said Nariman Behravesh, chief economist at Englewood, Colorado-based IHS Inc. (IHS) "Households can see homes selling in their neighborhoods, they know what is happening to their home value, and as a result they are going to spend more."

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