U.S. Department of Housing and Urban Development and Federal Housing Administration

We have included the most recent information available at the date of publication. At the end of each section, we include a list of resources with web links where you can find updates, as well as information about additional programs and other helpful information related to the subject.

President Lyndon B. Johnson established the Department of Housing and Urban Development (HUD) in 1965 to confront the nation's housing and urban challenges. While there were a number of federal housing programs before HUD's establishment, HUD consolidated its oversight into a cabinet-level agency. The mission of HUD is "to create strong, sustainable, inclusive communities and quality affordable homes for all." HUD funds and oversees a wide range of community development and housing-related activities aimed at preventing homelessness, providing rental housing, fighting housing discrimination, enhancing community and economic development activities, and increasing homeownership opportunities.

The Federal Housing Administration (FHA), the largest mortgage insurer in the world, is part of HUD. FHA increases homeownership opportunities in the United States by expanding mortgage financing opportunities and has historically provided stability to the housing market during times of economic crisis.

OVERVIEW OF THE FEDERAL HOUSING ADMINISTRATION

The FHA provides mortgage insurance that protects lenders in case of borrower default. It predates the secondary mortgage market, having been created in 1934 as a way to stimulate the housing industry during the Great Depression. Because FHA lending parameters allow for higher loan-to-value ratios and somewhat lower borrower credit scores than are typical for prime conventional loans, FHA has been an important source of mortgage credit for households that might otherwise find it difficult to obtain this credit, such as low- and moderate-income households and first-time homebuyers. FHA's volume generally varies based on the credit standards of other sources of mortgage financing and on the fees it charges. Lenders are protected by FHA's Mutual Mortgage Insurance Fund, which is sustained by borrower premiums.

FHA business is primarily conducted by four regional Homeownership Centers, or HOCs, in Atlanta, Philadelphia, Denver, and Santa Ana. Although lenders should send their questions to the FHA Resource Center (not the HOC) for immediate acknowledgement and tracking, certain case-specific issues are subsequently referred to the appropriate HOC.

GINNIE MAE

Ginnie Mae is short for Government National Mortgage Association. Ginnie Mae does not originate or purchase mortgage loans and does not issue mortgage-backed securities (MBS). Instead, Ginnie Mae guarantees investors the timely payment of principal and interest on MBS issued by private lenders and others that are backed by pools of mortgage loans insured or guaranteed by the Federal Housing Administration, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture's Rural Development, and the U.S. Department of Housing and Urban Development Office of Public and Indian Housing.

Ginnie Mae securities are the only MBS to carry the full faith and credit guaranty of the United States government.

This section describes the paths by which a bank may become an FHA lender, provides information on resources for banks that participate or are considering participation, and describes the secondary market for FHA loans before turning to descriptions of FHA and HUD programs. While most single-family homeownership programs are covered under Title II of the National Housing Act of 1934; certain types of specialized mortgage lending, like small-scale renovations and manufactured housing, are covered under Title I of the Act.

Title I programs covered in this section:

Property Improvement Loan Insurance: Affordable loan insurance for light or moderate renovations to a variety of residential and nonresidential properties.

Manufactured Home Loan Insurance: Insures mortgages for manufactured homes that are classified as personal property or chattel (meaning moveable property). The mortgages may also finance a lot on which to place a manufactured home.

Title II programs covered in this section:

203(b) Mortgage Insurance Program: The core FHA single-family mortgage insurance program, which allows low down payments for the purchase of a primary residence or its refinance. In addition to a discussion of the basic program, special features for certain populations and geographies that experience higher barriers to credit access are covered.

Streamline Refinance: Allows homeowners to refinance an existing FHA-insured loan to a lower interest rate or to a different type of mortgage with reduced documentation and underwriting standards, saving on transaction costs.

203(k) Rehabilitation Mortgage Insurance: Mortgage insurance for loans that finance both the purchase of a home (or refinance of an existing mortgage) and renovation costs in a single mortgage.

Other HUD programs covered in this section:

Section 184 Indian Home Loan Guarantee Program: This HUD program operates separately from FHA and provides access to credit for American Indian and Alaska Native families, Alaska Villages, Tribes, or Tribally Designated Housing Entities.

Good Neighbor Next Door: This HUD program operates separately from FHA and provides a discount on the purchase price for public servants (teachers, police, firefighters, military) to purchase HUD-owned homes in certain distressed communities.

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DOING BUSINESS WITH THE FHA

Benefits

FHA's low down payment 203(b) flagship program has helped millions of borrowers purchase their first homes and is one of the most recognized mortgage loan products available today. Developing the expertise needed to understand FHA's expectations for lender operations and loan delivery can be complicated; however, there are resources to help community banks. The FHA also insures loans for manufactured housing, rehabilitation, and for improvements on existing homes, so doing business with the FHA may offer a significant set of new opportunities to serve a wide range of borrower needs.

Delivery Options

Community banks can participate in two ways in FHA single-family programs. First, a bank may become an approved supervised lender with direct endorsement (DE) authority. Banks granted full FHA approval authority can originate, underwrite, fund, and service FHA-insured single-family loans. Or, a bank can become an FHA third-party originator (TPO), which allows origination only.

Smaller lenders often turn to investors or aggregators to help them carry out underwriting, funding, and/or secondary market sales functions. Correspondent lenders typically fund loans in their own names and then sell them to investors, who in turn sell the loans into the secondary market. In some cases, the correspondent lenders handle the underwriting in-house. In others, the investor acts as the underwriter. Smaller lenders that are interested in originating loans but do not have the internal capacity to either underwrite or fund the loans can also work with investors to carry out the origination function while looking to the investor to underwrite and fund the loans in the name of the investor. Many state and local housing finance agencies, as well as certain Federal Home Loan Banks, also work directly to provide mortgage-lending options.[1]

Originating FHA loans as a third-party originator sponsored by an approved lender

Non-FHA approved banks can originate FHA loans without going through the formal FHA approval process by working with an FHA-approved lender to sponsor them. Becoming a TPO can be useful to banks that are interested in offering FHA loans to their customers, but may not meet minimum standards or have the internal capacity needed for FHA lending, or that wish to avoid the additional costs associated with FHA approval and annual recertification.

TPOs originate FHA loans that are underwritten and funded in the name of a sponsoring FHA-approved lender. However, as a TPO, the bank is subject to both FHA loan standards and those of the sponsoring lender, sometimes referred to as overlays. In addition, TPO banks are reliant on their sponsoring lenders for underwriting approval and funding timelines. For these reasons and others, banks may choose to become an approved FHA supervised lender with direct endorsement authority.

Originating FHA loans as an approved supervised lender with direct endorsement authority

To originate, underwrite, and fund FHA loans, a lending institution must be approved by HUD as an FHA lender.

Approval process: Banks must follow a two-step approval process in order to gain this status.

1. Conditional authority (basic lender approval). Conditional authority is the authority of a bank that has applied for and received basic FHA mortgagee approval. A bank applying for this status must meet minimum financial and operational standards pertaining to net worth, liquidity, staffing, and quality control that are laid out for FHA supervised lenders. Banks applying for underwriting authority must have an underwriter on permanent staff. In addition, the bank must have five years of experience in the origination of single-family mortgages, or a principal officer with a minimum of five years managerial experience in the origination of single-family mortgages. Banks that are considered large entities as defined by the U.S. Small Business Administration (SBA), (net worth greater than $500 million) are required to submit audited financial

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[1] Detailed information regarding State Housing Finance Agencies can be found in the *Affordable Mortgage Lending Guide, Part II: State Housing Finance Agencies*, https://www.fdic.gov/mortgagelending. Detailed information regard-ing Federal Home Loan Banks can be found in *Affordable Mortgage Lending Guide, Part III: Federal Home Loan Banks*, https://www.fdic.gov/mortgagelending.

statements, both at the time of application and as part of an annual recertification process. Banks with a net worth of less than $500 million are required to submit a copy of their call reports each year.

A bank interested in becoming an FHA-approved lender can submit an online application using the HUD FHA application portal. The bank must receive separate approval for making Title I loans and Title II loans but can apply for both at the time of its initial application. Should a bank apply initially only for Title I or Title II approval status, it can apply for the other status later.

Although a bank can originate FHA loans once it has been approved as an FHA supervised lender, it is not eligible to underwrite FHA loans until it receives FHA direct endorsement (DE) authority

2. Direct endorsement authority. Once a bank has received conditional authority, it must obtain unconditional DE authority to underwrite, fund, and submit FHA loans directly for endorsement.

In general, to receive unconditional DE authority, a bank must submit a written application to the jurisdictional HOC for the state where the bank's home office is located. If approved, the bank will receive a test case phase approval letter, reference materials, and a list of specific requirements that the bank must meet. The bank will also be required to participate in an entrance conference with the HOC before the bank is allowed to submit test cases.

During the test case phase, the bank will submit its FHA loan files for approval to the appropriate HOC. The HOC will issue a firm commitment (approval) or a firm reject (denial) for each case submitted. Cases that receive a firm commitment are approved to close and be submitted for insurance endorsement. Upon receipt of 15 firm commitments within a period of 12 consecutive months following the date of the entrance conference and a determination that the bank has demonstrated an acceptable understanding of FHA underwriting and other requirements, the bank is granted full and unconditional DE approval.

One or more designated underwriters employed by the bank serves as the bank's FHA subject matter expert(s) as designated DE underwriters. The underwriter's role and responsibilities are critical elements of the DE Program and include ensuring loans comply with FHA policies and procedures from the underwriting and verification process through loan closing and certification. Generally, DE underwriters must have a minimum of three years of recent full-time underwriting experience.

DE lenders must complete an endorsement process for each FHA loan after closing. Most DE lenders submit the insurance application electronically through the FHA Connection electronic system and prepare an FHA case binder for review by the HOC, which will determine whether the files meet the necessary requirements.

Lender Insurance Program

The Lender Insurance (LI) Program enables high-performing FHA-approved lenders to endorse FHA mortgage loans without a pre-endorsement review. To become an LI lender, lenders must have and maintain at all times, unconditional DE authority and must have a claim/default rate for the state(s) in which the unconditional DE lender has underwritten loans that is at, or below, 150 percent for at least two years before its application for participation in the LI Program.

Selling FHA Loans

Lenders do not typically keep FHA loans in their portfolios. Instead, they are generally pooled and used as collateral for mortgage-backed securities (MBS). FHA does not purchase and securitize loans. Instead, FHA loans are delivered to the secondary market through Ginnie Mae's guaranteed mortgage-backed securities. Securities are issued by private financial institutions and the timely payment of principal and interest to investors in these securities is guaranteed by Ginnie Mae, a government office within HUD. FHA-approved lenders can deliver FHA-endorsed loans as MBS by becoming a Ginnie Mae approved issuer or by selling FHA loans to third-party Ginnie Mae approved industry conduits or aggregators. See Resources at the end of this section for a list of Ginnie Mae approved issuers.

System Requirements and Quality Control

FHA loans can be manually or electronically underwritten. All FHA loans are required to go through the FHA TOTAL (Technology Open to Approved Lenders) Mortgage Scorecard system except Streamline Refinances and assumptions. The TOTAL Mortgage Scorecard is based on credit and application variables and, when combined with an approved automated underwriting system's functionalities, is used to provide an underwriting recommendation that either deems the borrower's credit is acceptable or requires the loan to be underwritten manually by an FHA DE underwriter.

All FHA-approved mortgagees must also implement and continuously have in place a written quality control plan for the origination and/or servicing of FHA-insured mortgages to assure compliance with FHA's origination and servicing requirements and to protect against unacceptable risk and fraud. The quality control function must be independent of the origination and servicing functions and can be fulfilled by using in-house staff or an outside firm.

Neighborhood Watch Early Warning System

Neighborhood Watch is an electronic database and monitoring system intended to help HUD/FHA staff, FHA lenders, and the public analyze the Title II loan performance of FHA lenders. Neighborhood Watch data can be used to compare a specific lender's FHA loan performance against other lenders in a geographic area in order to help identify and address potential problems related to early delinquency patterns. Specifically FHA uses a "compare ratio" to compare a lender's early default rate (typically the percentage of loans that are 90 days or more delinquent within the first two years of origination) against those operating within the same region. Lenders with a compare ratio at twice the average or higher are subject to disciplinary action. More information about Neighborhood Watch can be found at https://entp.hud.gov/sfnw/public/.

RESOURCES

Direct access to the following web links can be found on FDIC's Affordable Mortgage Lending Center at https://www.fdic.gov/mortgagelending.

FHA Handbook: Single Family Housing Policy Handbook 4000.1
https://www.hud.gov/program_offices/housing/sfh/handbook_4000-1

FHA lender approval application
https://www5.hud.gov/FHALender/

FHA lender approval application instructions
http://portal.hud.gov/hudportal/documents/huddoc?id=SFH_LEND_REQAPPROVAL-LEAP.PDF

Homeownership Centers and areas served
https://www.hud.gov/program_offices/housing/sfh/sfhhocs

Neighborhood Watch
https://entp.hud.gov/sfnw/public/

Doing Business with Ginnie Mae
https://www.ginniemae.gov/doing_business_with_ginniemae/Pages/default.aspx

Ginnie Mae approved issuers
http://www.ginniemae.gov/issuers/third_party_providers/Pages/document_custodian.aspx

FHA Connection Electronic System
https://entp.hud.gov/clas/index.cfm

FHA Lender Insurance Program
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/lendins

FHA TOTAL Mortgage Scorecard
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/total

Using FHA's Section 203(b) Mortgage Insurance Program

The FDIC talked with community bankers about their participation in the Federal Housing Administration's Section 203(b) Mortgage Insurance Program. The following are excerpts from these discussions.

The Section 203(b) Mortgage Insurance Program is the core FHA single-family mortgage insurance program, which allows low down payments for the purchase of a primary residence or for refinancing a mortgage.

Working with the FHA

One small community bank recently decided to add home mortgage loans to its line of products. The bank representative explained that as the bank did its product evaluation, management concluded that the Federal Housing Administration's (FHA) Section 203(b) Mortgage Insurance Program would be of interest in the local market.

The lender added that the bank wanted to offer a loan that would help first-time homebuyers who needed a lower down payment option. Aligning that market need with the bank's policy of selling 100 percent of the mortgage loans it originates into the secondary market led them to the Section 203(b) Mortgage Insurance Program.

Becoming an FHA Lender

The banker said that one challenge to its plan to originate FHA loans was that the bank would be unable to gain approval as an FHA direct endorsement (DE) lender because it fell short of the requirements for audited financials and minimum asset levels set by the FHA. The bank, therefore, chose to pursue table funding. Under this arrangement, the bank acts as an FHA-sponsored third-party originator (TPO) to originate the loan and then works with an FHA-approved direct endorsement (DE) sponsoring lender or mortgagee to underwrite and fund the loan.

As a TPO, the bank meets with the borrowers and originates and processes the initial loan application, including collecting FHA-required documentation. The bank then sends the loan file to the FHA DE mortgagee that underwrites the loan and communicates any outstanding closing conditions that need to be satisfied by the borrower back to the bank. Once fully approved, the mortgagee initiates the closing and the loan is funded and closed in the mortgagee's name.

The representative said, "The first table-funding FHA-approved mortgagee that the bank worked with took too long to get the approval in place due to a cumbersome process. However, once we identified more effective DE partners, established clear and open lines of communication, and initiated the process to become approved to originate FHA loans as a TPO, we were able to get up and running within a couple of months." She went on to say that "the quality of the DE sponsoring lender can make a huge difference in the efficiency of the loan approval process. When you have an outstanding issue on a loan during the underwriting process, you want to know that you and your sponsoring lender will be working as a team to resolve the issue as effectively and efficiently as possible."

Challenges of Offering FHA Loans

When asked what the biggest challenge is with using the FHA 203(b) product, one of the representatives stated that it is forming an effective partnership with a strong FHA approved DE underwriter. As the originator of the loan, the bank is responsible for meeting with borrowers, taking loan applications, and collecting FHA-required documentation. Even after completing an origination package and sending it off to the underwriter, back-and-forth communications and competing business priorities of the underwriter (including transactions with other TPOs) occasionally extend wait times.

Another banker, who is also a TPO, pointed out that "the biggest challenge my bank has is that since we are not the lender, we do not have as much control over the approval as we do with loans that we underwrite ourselves; however, in our experience, the FHA product is really not difficult [to originate] once you gain some experience." The representative went on to say that his bank only does a few mortgages a year, but has been making Section 203(b) loans for the past eight years so customers can benefit from the 15-year and 30-year terms. "If you are already originating mortgage loans, the learning curve is fairly easy."

Benefits of Offering FHA Loans

One bank representative said that her bank combines the FHLBank of Cincinnati's Welcome Home program with its FHA loans. Welcome Home provides up to $5,000 for down payments and closing costs to eligible homebuyers with a minimum subsidy match of $500 provided by the borrower.

Another banker added that his bank combines the FHA 203(b) product with grants from the Federal Home Loan Bank of Topeka. He said that overall, FHA loans are not a significant portion of the bank's mortgage lending business, but having it available is very important because it gives customers more options.

One banker estimated that 95 percent of her bank's FHA loans are for first-time homebuyers, including many younger borrowers who have not had the time or the financial experience to build a high credit score. She noted that FHA's credit score thresholds can be lower than government-sponsored enterprise (GSE) low down payment programs. Another helpful feature for young borrowers is the ability to use gift funds from relatives to cover a portion of the down payment and closing costs. Older, more established family members helping younger relatives buy their first home is a common and long-standing tradition in many communities, which FHA guidelines generally support. The representative also points out that many renters can actually save money by becoming homeowners. "Rents are high and it's often cheaper to buy a home than to rent."