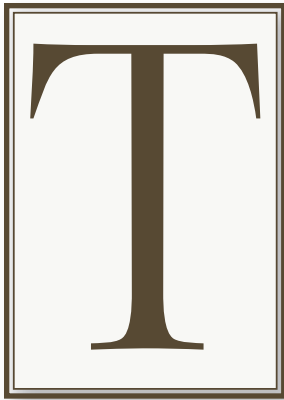






FHA's Revival

BY
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**Those looking to
become Federal
Housing Administration
lenders need to do
their homework first.
There are plenty of
pitfalls for the
unprepared.**



he federal government established the Federal Housing Administration (FHA) during the banking crisis of the 1930s as a means to stimulate the housing market by reducing risk to lenders, thus making them more likely to loan money. To accomplish that mission, FHA provides mortgage insurance on loans originated by approved lenders to protect against loss as the result of default.  According to its own estimates, the FHA—now part of the Department of Housing and Urban Development (HUD)—has insured more than 35 million mortgages since its inception by providing financing options to families that could not afford the conventional down payment on a home without assistance.  After the 1980s, however, FHA-insured loans began to lose their appeal with lenders. As lending practices evolved and modernized, the FHA was slow to adapt to the changes. And other factors—such as stringent administrative requirements and smaller loan limits—also hurt the desirability of FHA-insured mortgages.  All of these factors, coupled with the growth of subprime lending programs over the same time period, caused FHA loan originations to decline to an all-time low share of the market. According to FHA data, the FHA's share of all home financing plummeted from 14.1 percent to 3.8 percent from 1999 to 2006. 

Now, more than 75 years later, the FHA lending program is being reborn. The Housing and Economic Recovery Act (HERA) and the Obama administration's Making Home Affordable program have made FHA lending an integral part of our financial recovery.

As traditional conforming mortgage lending and credit guidelines tighten, FHA loans allow lenders to obtain financing for borrowers who otherwise might not qualify for a conventional home loan. As a result, FHA-insured loans are the single fastest-growing mortgage product in the market today, skyrocketing to approximately 30 percent of all U.S. loan originations, according to the FHA.

Another reason for the sudden resurgence is the result of changes within the program, such as the FHA Modernization Act, passed in 2008 as part of the Housing and Economic Recovery Act that enables lenders to originate more loans. As lenders search for suitable options to replace subprime lending, and with the government working to make FHA programs more attractive, lenders are turning to FHA-insured loans to enhance their loan portfolios, manage their credit risk and grow revenue.

Many lenders either new to FHA-insured lending or reviving a dormant FHA lending program are realizing that the FHA license-approval process and lending guidelines can be complex. In addition, the Helping Families Save Their Homes Act that President Obama signed in May 2009 now imposes stricter reviews of lenders seeking to become FHA-approved lenders. As a result, some lenders will find that navigating their way through the maze of FHA lending requirements without support is too difficult and costly in terms of time and labor. That's why many lenders are either recruiting professionals with FHA experience or turning to

outside consultants to help get them up-to-speed more quickly and accurately.

Navigating the FHA maze

FHA lending requires a significantly different skill set and knowledge base than conventional lending. There are several issues to consider before starting your institution's FHA lending program. They include building a business case for FHA-insured lending to present to upper management; gaining FHA license approval from HUD; and, ultimately, implementing and managing a successful FHA lending program.

First-time FHA lenders, or those reviving their FHA lending programs, may encounter some difficulty in obtaining their FHA license from HUD. A successful license application depends on the development of a detailed quality-control plan. This plan outlines how lenders will operate all aspects of their FHA program and must be submitted at the time the application is filed. Overall, a well-prepared quality-control plan will help the lending organization manage the risk associated with the program and avoid issues with loss coverage and potential fines for non-compliance.

FHA lenders must learn all of the relevant HUD guidelines, upgrade the training and certifications of its underwriters for FHA lending, and educate loan originators and customer service personnel in FHA program requirements.

According to HUD, the current processing time for an applicant to become an FHA-approved lender is approximately two months if the application is approvable as submitted. However, additional requests for information by HUD or the rejection of an initial application can add another month or more of processing time.

Whether a lender is a first-time licensee or seeking

recertification, failure to adhere to the FHA's detailed and precise business processes can postpone a lender's ability to capitalize on this current market opportunity. Therefore, hiring experienced FHA lending personnel or partnering with outside experts might be the quickest and most profitable way to get started. Monica Stinchfield, senior vice president of mortgage lending at First Federal Savings Bank, Evansville, Indiana, came to this realization when starting her bank's FHA program.

"With the market changing, we decided we needed to offer FHA programs to meet the needs of our borrowers, but interpreting all of the rules and guidelines required to become an FHA-approved lender was absolutely mind-boggling," Stinchfield says.

"Having the ongoing support of a subject-matter expert to get us up-to-speed on FHA lending has been critical to a successful application approval and implementation," she says.

In addition to filing an accurate license application and building a solid quality-control program, ongoing training and process development also are important components of a profitable and compliant FHA implementation.

Delivering FHA training that gets results

Staff training on FHA programs, requirements and processes is an important part of guaranteeing that internal team members are aware of their roles. They need to understand their responsibilities throughout every part of the transaction, as each step in the FHA loan process has its own specific rules and guidelines.

In fact, demonstrating FHA proficiency is so important to HUD that the regulator will check to see if all members within an FHA-approved institution are properly trained to execute their part of the lending process. HUD also requires a financial institution to have a continuing education program to help keep staff abreast of program changes or new regulatory requirements.

An education program should be carefully tailored around the specific FHA products the institution offers and should leverage existing internal expertise and processes. In addition, a comprehensive training program should focus on the most effective and compliant ways to originate, process, underwrite and service FHA loans.

Loan origination: The FHA crossing guard

For each step in the FHA lending process, there are rules and guidelines that must be strictly adhered to in order for the borrower's loan to be approved in a timely manner. Any deviation from these guidelines, and the loan may not be approved by the FHA or through conventional methods.

How smoothly and efficiently the loan process proceeds depends on what happens at this stage. The loan originator

is responsible for collecting the proper documentation, which is a fairly significant task because the entire loan approval process can succeed or fail based on the paperwork submitted.

In short, it may help to visualize the loan originator as the FHA "crossing guard." The loan originator is in charge of ensuring that all documents are accurate and complete before being allowed to "pass" along to the loan processing stage.

To ensure that your organization is following the correct FHA loan origination procedures, loan officers should be properly trained on standard FHA disclosures, loan application documentation and statutory loan limits.

Stinchfield says, "As an institution re-familiarizing itself with FHA lending after a long absence, we wanted to experience as little interruption to our day-to-day operations as possible while still ensuring the implementation of a well-managed, compliant program."

She adds, "So, in addition to hiring an outside consultant to meet our FHA training needs, we also purchased a loan documentation package to take the guesswork out of knowing exactly what FHA documents are needed and when they should be generated during the loan process."

One other important aspect of FHA loan origination is a solid understanding of the maximum FHA mortgage amount. This is especially important, as applicable loan limits are determined by the county in which the property is located.

Additionally, it is necessary to understand how to perform standard FHA calculations, as these numbers drive the entire loan process. A loan originator must be able to correctly figure the base loan amount, the minimum down payment required (3.5 percent), the upfront and monthly mortgage insurance premiums, and the total loan amount. Again, failure to calculate any of these items correctly will greatly slow down the FHA loan approval process.

Loan processing: Putting it all together

The FHA loan processor is responsible for reviewing all documentation for accuracy and completeness. As the loan processor prepares a file for underwriting, he or she must make sure all proper documentation is included, all numbers are calculated correctly and that everything is stacked in the right sequential order for review. A well-processed FHA loan file increases the borrower's chances of getting the loan approved and can decrease the amount of time it takes to close.

Because the loan processor does the majority of the legwork, a comprehensive training program is critical. Besides requiring a vast depth of knowledge about FHA loan documentation, income and credit verifications, and FHA-approved appraisals, a loan processor must also learn how

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to enter and move a loan through the FHA Connection solution. The FHA Connection provides approved FHA lenders real-time access to the FHA's single-family origination and servicing systems to request things such as case numbers, mortgage insurance certificates and the status of mortgage insurance premiums.

In addition to the FHA Connection, loan processors should be educated on the FHA Technology Open to Approved Lenders (TOTAL) Scorecard system. FHA TOTAL Scorecard is used to evaluate credit risk on loans that are submitted through an automated underwriting system.

TOTAL evaluates a borrower's credit history, income, cash reserves and other components of creditworthiness. While TOTAL does not decline loans, it does save time for the underwriter by returning either an "approve" rating or referring the loan for manual underwriting.

Becoming a Direct Endorsement underwriter

Once an FHA loan package is assembled, it moves to underwriting. An FHA lender's underwriting team must be trained and certified by HUD as Direct Endorsement (DE) underwriters.

To qualify as a DE underwriter, an underwriter must have three years of full-time experience reviewing both credit applications and property appraisals. Underwriters must have the ability to demonstrate underwriting knowledge and experience, and must not have any sanctions against them. They must also not be named on the Limited Denial of Participation (LDP) or General Services Administration (GSA) lists or in HUD's Credit Alert Interactive Voice Response System (CAIVRS). Finally, underwriters must have successfully completed the DE training program.

Besides the qualifications already stated, HUD asks lenders to submit 15 pre-closing test cases for review. If the lender demonstrates acceptable underwriting in these 15 cases, a letter granting unconditional authority is issued. If a lender's underwriting is not acceptable, additional test cases will be required.

HUD also polices the underwriters' activities on an ongoing basis. As part of running a well-managed and compliant FHA program, lenders need unremitting focus on their risk-mitigation strategies. This includes such efforts as the continual improvement and maintenance of the quality-control plan; fulfilling all audit requirements, including annual recertification, regulatory examinations and mortgage reviews; implementing industry best practices; participating in HUD technical reviews of their DE underwriters; and tracking their loan default rates through the Neighborhood Watch program.

Understanding FHA servicing requirements

Servicing FHA loans can be one of the most challenging aspects of working with government mortgage products.

Changes in the servicing area have a significant impact on how lenders operate on a day-to-day basis.

When training a servicing department on FHA loans, it is important to detail HUD's preferred loss-mitigation methods and discuss the various relief options available. It is left to the servicer's discretion as to the loss-mitigation options chosen; however, participation in the FHA loss-mitigation program is not optional. As a reminder, it is important to retain a complete audit trail confirming compliance with all loss-mitigation requirements.

Once your FHA program is up and running, it might be beneficial to get an arm's-length compliance review of your

FHA implementation and staff training. Undergoing a comprehensive compliance review may provide a clearer picture of any remaining risks and offer recommendations on how to proactively manage them, discern best practices and test the adequacy of internal controls before they are tested by HUD in its exam.

Failure to adequately maintain a continuous compliance process can be costly from a financial, legal and reputational standpoint. More than 100 mortgage lenders recently felt the full impact of

what happens when you are out of compliance. HUD issued an announcement detailing how its Mortgagee Review Board banned these lenders from the FHA single-family program due to various program violations. In one case, a lender from New Jersey was suspended from making FHA loans for five years and charged more than \$151,000 in fines.

While greater accessibility to the FHA loan program is a positive development for our economy, its rapid growth should be carefully monitored. As with the subprime mortgage market, history has shown that whenever a loan product's popularity increases so substantially in a short period of time, greater safeguards are vital. Such safeguards include ongoing training of a financial institution's staff, the continual monitoring of loan package submission and documentation quality, and tougher penalties for lenders that do not meet the highest standards of conduct.

As FHA loan volumes continue to reach new heights, the addition of FHA lending may become a key component in your organization's growth. So getting things right the first time around could make or break your FHA business.

After all, proper FHA implementation and training can mean the difference between a lender drowning in incomplete or inaccurate files versus a lender generating profitable growth by submitting files that are quickly approved. **MB**

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