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Statement of the Shadow Financial Regulatory Committee on Proposed Increases in FHA Insurance Limits

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The Federal Housing Administration (FHA) has proposed that the maximum size of the mortgage loans it can insure be increased from $152,000 to $173,000. The federal mortgage insurance program administered by the FHA was created to facilitate home ownership by Americans with moderate incomes, who did not have the cash available to meet the down-payment requirements on conventional loans. When FHA began operations, private mortgage insurance did not exist, lenders were generally unwilling to make loans without sizable down-payments, and secondary market institutions such as Fannie Mae and Freddie Mac did not exist.

The Shadow Financial Regulatory Committee questions the extent to which the federal government should attempt to promote home ownership. Regardless of one's views on that broad public policy issue, the economic evidence indicates that reducing the cost of mortgage credit is an inefficient means of encouraging home ownership. The benefits are hard to target and it is not clear that the supply of <u>housing</u> (as distinct from mortgage credit) has been affected significantly. However, even if government mortgage insurance has been effective in the past in making home ownership feasible for middle-income Americans, there is little justification for an increase in the size limit on FHA loans.

The proposed $173,000 limit would be 85 percent of the maximum size of mortgage that can be sold to Fannie Mae and Freddie Mac. That maximum (now $203,000) has been raised regularly. Future increases in that limit would result in further increases in the FHA ceiling.

Normally, borrowers who can obtain mortgages as high as $170,000 are those with incomes of over $70,000. There is certainly no justification for mortgage finance programs aimed at the upper 15 percent of the income distribution. The private financial markets of the U.S. are very well able to provide credit for these people. In fact, the proposal by the FHA seems aimed more at increasing FHA's market share in the mortgage insurance business, at the expense of the private mortgage insurers, than in accomplishing any relevant social goals. For similar reasons, the Committee would also oppose any further increase in the maximum loan size that can be purchased by the government-sponsored secondary market entities.

Private mortgage insurance is now widely available. The Committee sees no reason why the federal taxpayer should take on the risks of insuring mortgages that the stockholders of private mortgage insurers are willing and able to assume. Moreover, lenders now offer conventional loans with very low down-payments.