THOSE F.H.A. MORTGAGES:

They're Throwing Money Away Again

By Bruce J. Bergman

In a general sense, we are all aware that the federal government is squandering millions of dollars with endless programs in its vast sea of bureaucracy. Precisely where the dollars are being flushed away on a concrete, day-to-day basis is perhaps less apparent. A good, or bad, example is the FHA insured mortgage program.

To appreciate the flavor of the bureaucratic morass and how expensive and absurd it can all become is illustrated by the actual case history which occurred recently in New York City.

A gainfully employed woman owned a two family house with the rental unit yielding an income. For unknown reasons, the woman defaulted on her FHA insured mortgage. When all attempts by the bank to discover the problem and resolve it proved entirely unavailing, a foreclosure action was begun.

During the many months of the foreclosure proceeding, which the woman totally ignored, no payments whatsoever were made to the bank. The woman lived rent free. Finally, the foreclosure sale took place and, there being no other purchasers, the bank "bid in" at the sale, becoming the owner of the property. This was in October.

Before the FHA will pay off on its mortgage insurance to the bank, it requires the foreclosed premises to be vacant and it will reimburse the bank for some percentage of the cost of the required eviction. Of course, this is at the taxpayer's expense. Consequently, on the very day of the sale, a bank's officer called the woman, told her the bank now owned the house and asked when she intended to leave. "I'll get back to you," she replied.

A few days later there had still been no word so the officer again called. Again the woman promised to reply. There was none. Further efforts to call the woman at work found her always "unavailable."

Realizing that the woman simply intended to live at the premises for as long as she could delay, the bank finally began its eviction proceeding. Now the woman decided to pay a lawyer to "buy" more time.

The attorney could do little for her, except that the Courts are loath to put anyone in the street so she received a reprieve through the end of the following January on condition that a nominal rent be paid to the bank.

When the end of January arrived, the woman, and, by the way, her tenant, were still occupying the premises. The bank sent the appropriate eviction papers to the Sheriff and was required to pay $1,000 in advance as the expected cost of moving the belongings of the woman and the tenant. This, too, was an amount reimbursible by FHA and thus the taxpayers.

Another Ploy

With the eviction set for early March, the woman's next ploy was to go directly to the FHA and ask for a lease so she could remain at the house. Although she had proven herself to be totally irresponsible, the woman's request was viewed favorably by FHA staff people, who, in turn, phoned the bank and asked that the eviction be called off.

"Look," said the bank's officer, "you might be an FHA employee speaking to me, but I don't know that. People have tried tricks like this before. Anyway, your rules require me to turn over the premises vacant. How do we collect the insurance if these people stay in the house, because then it is not vacant. Will FHA's other departments know you told me to stop the eviction? Why don't you send me a letter authorizing this so there is no confusion? In the meanwhile, we'll adjourn the eviction for a couple of weeks."

"Fine," said the FHA lady.

A couple of weeks later there was no letter from the FHA. The day before the adjourned date of the eviction, the bank's officer finally tracked down the FHA staffer who had initiated this mess. It seems that the valued tenant was now giving the FHA the same kind of runaround she had given the bank. The leases were sent to the woman for signing but were never returned. FHA now made a commitment to lease the house but had no lease document to show for it. They asked the bank to adjourn the eviction one last time.

Well, the typing, postage, phone calls and staff time may not break the taxpayer's back, even if we do multiply this nonsense thousands of times across the country, but cancelling the eviction the day before it is scheduled costs $350.00 to the movers who had set the time aside. That is $350.00 the taxpayer underwrites only because the FHA absolutely bungled a simple transaction.

Letter Still Not Received

Just to end the tale of FHA "efficiency", after the second adjournment of the sale, the confirmatory letter still had not been received by the bank. When the bank's officer called, this time two days before the eviction so no further charges would be incurred, the FHA lady said the letter had been mailed five days before.

Why hadn't it arrived? The FHA had sent the letter addressed to the bank, but at the address of the bank's private attorney — which assured that it would be undeliverable.

How this all comes about in the first place requires some background. When a bank decides to give a mortgage, it makes a business decision. It wants to know if the investment will be a sound one. Can the borrowers (called in this situation the mortgagors") meet the monthly payments? In the unlikely event of a default, is there sufficient equity in the property so that a foreclosure sale will exceed the amount of the mortgage and the expenses of a foreclosure sale?

When all the questions are explored and answered satisfactorily, the bank is in a position to decide whether it shall make the particular loan. There is, after all, a very heavy responsibility to shareholders in arriving at reasoned, responsible lending decisions. Obviously, if too high a percentage of mortgage loans go into default, and worse, if there is insufficient equity to cover the loss, the whole system fails.

Consequently, banks are extremely reluctant to give mortgages to people with low incomes. A purely dispassionate analysis reveals that their ability to meet the obligations on the mortgage is obviously less than that of people of more substantial means. This is not to place any blame upon the less affluent individual. Nor is it to make a social or a moral judgment. It is merely an observation of fact from a business viewpoint. (Sociology and perceived social obligations are an entirely different subject).

There is similar reticence on the part of banks to loan money for the purchase of property in a "depressed" or "changing" area - which may or may not be a euphemism for a slum. This is obviously most unfortunate for the couple who is constrained by economics to live in an area that lenders don't favor. But from a business point of view, can the banks be blamed? Why invest in property which shortly may not be worth the amount of the mortgage? Enter the Federal Housing Administration.

The dual dilemma of the low income borrower and the blushing bank is greatly alleviated by mortgage insurance underwritten by the FHA. In essence, the borrower is allowed to submit a much smaller down payment while the resultant greater risk mortgage is insured by the FHA. Then, if there is

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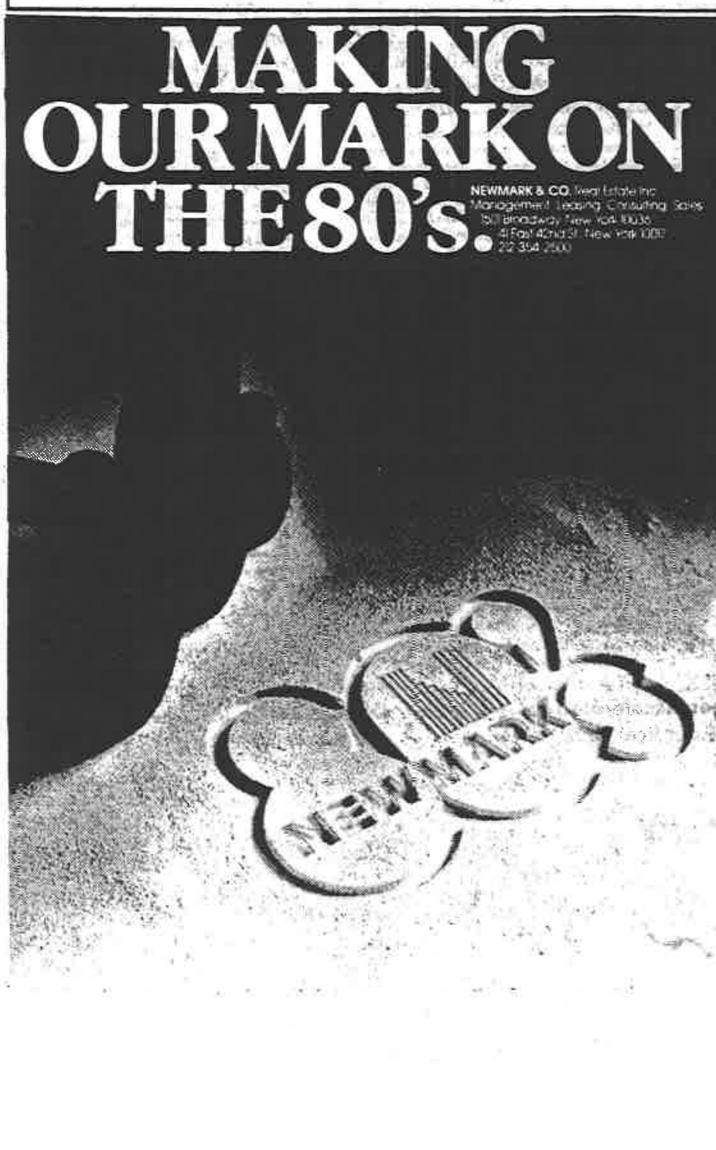

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a default, most, but not quite all, of the bank's loss will be paid by the government. A mix of varying degrees of FHA insurance combined with some social consciousness and sundry anti-redlining statutes, serves to make available mortgage money to those who probably would not otherwise obtain it.

Other Benefits

A corollary benefit is the availability of mortgages for young couples or lower middle class purchasers who will buy in "acceptable" neighborhoods but simply don't have enough money to pay the usual minimum down payment of twenty percent. They, too, are aided by the FHA program.

So far the system of FHA insurance sounds very good - and it would be, philosophical objections aside, if the Government acted with something even approaching the efficiency standards expected in the private sector. Sadly, however, it does not.

FHA mortgage commitments take at least twice as long to issue as conventional bank mortgage decisions. The result is that purchasers and sellers wait while the bureaucracy does whatever it does with, at best, fifty percent of the speed of banks.

For all the time the FHA invests in its process, most bankers will tell you that no more accurate information upon which to base a lending decision ever emerges. The default rate for FHA insured loans is still considerably higher than for conventional loans.

Furthermore, as might be expected of the Government, the FHA imposes incredible numbers of rules, regulations, requirements and forms upon a bank which participates in the program. Banks, in turn, do not wish to subject themselves to an expensive burden without due recompense. Accordingly, they charge, as indeed they must, additional fees, usually embodied in "points" to be paid by the seller. (A point is one percent of the mortgage amount.) Since the FHA rules won't allow the purchaser to absorb these points, the unwary seller just helped to underwrite the mortgage.

Of course, there are ways around this for the seller. If he pays points, his effective selling price is lower. To avoid such an undesirable consequence and with the concurrence of buyer and broker, the seller often increases the price by the cost of the points he'll have to pay. Now the purchaser, who probably can't afford it in the first place, is swallowing this cost.

There are other problems too. Normally, when a bank gives a mortgage, it will not concern itself with minor physical details of the premises. Either the value of the property is such that it will or will not support a mortgage of a certain magnitude. The FHA, however, is different. It makes itself a force in the bargain and imposes terms upon the parties - really the seller - which would not have been consented to but for the governmental intervention. For example, the FHA will, in many instances, prepare a laundry list of repairs it wants done to the house, such as corrective work on awnings, window frames, gutters, driveway cracks and plaster - each an actual case example.

Moreover, the FHA can, and has, demanded replacement of any rotted wood, weatherstripping of windows, repainting of exterior trim, installation of new light switches and caulking of tubs, among others. Without outside influence, many of these items would be too trivial to require remedial work. As a consequence, sellers would prefer to do business with purchasers securing conventional mortgages.

All these idiosyncracies of the FHA program may be viewed as more annoyance than anything, particularly when weighed against the obvious benefit of solving what would probably be the insoluble problem of providing mortgages to peole in places banks could reject. But the difficulties go deeper and become very expensive for anyone who pays taxes.

Instead of allowing the banks to do all the work, with the FHA just offering insurance in cases that fit guidelines, they engage a huge and costly workforce for their own methodology. They develop, create, print and disseminate scores of rule manuals consisting of thousands upon thousands of pages per series of manuals.

Too Much Bureaucracy

The regulations, which just seem to beget further, additional and extra amendments, changes, revisions and updates, not only keep the FHA minions busy at the expense of the taxpayers, but they force banks to hire staff just to wade through the enormous volume of regulations. Ultimately, that costs the public money in the form of more expensive banking services.

But it goes still further. Banks do not want to foreclose mortgages. It usually costs them money. It's time consuming, bad for public relations and generally something to be avoided if at all possible. Thus, the banks will, as a rule, be far more liberal and generous with defaulters than the public woul ever imagine - not necessarily because the bank staffs are any more compassionate than other people, but because such is the sensible approach. Therefore, after the bank has done all it can to help save the mortgage, it then pushes hard to bring the distasteful action to a final conclusion. Here too, FHA regulations intrude.

Their rules are excessively ritualistic. At numerous points in the foreclosure process, the FHA requires special written notice be sent by the bank to the defaulting mortgagor outlining all sorts of options available to the defaulter under FHA procedures. But real estate lawyers and bankers know that once a foreclosure action becomes a reality, the homeowner, sadly, is either unable or unwilling to remedy the situation. (All the letters in the world will have little effect upon the divorce or the lost job, two frequent causes of mortgage defaults).

How the problems in the FHA program can be translated into reality are demonstrated by the story discussed earlier.

While banks are far from perfect, they are not nearly as inefficient as the FHA. If the FHA adopted bank methods, or better still, let the banks do all the work with FHA then just insuring the mortgages which need it, enormous amounts of money would be saved. Significantly though, the public would be served just as well, if not better.

Yes, the FHA renders an invaluable service to people most in need. But surely there is a better way to do it.

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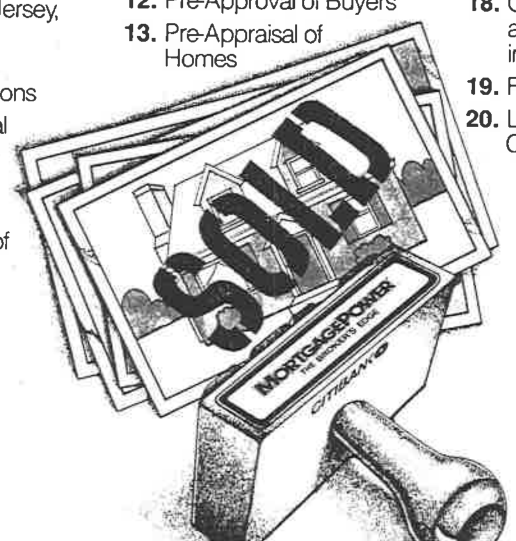

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