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# FHA Digging Out After Loans Sour

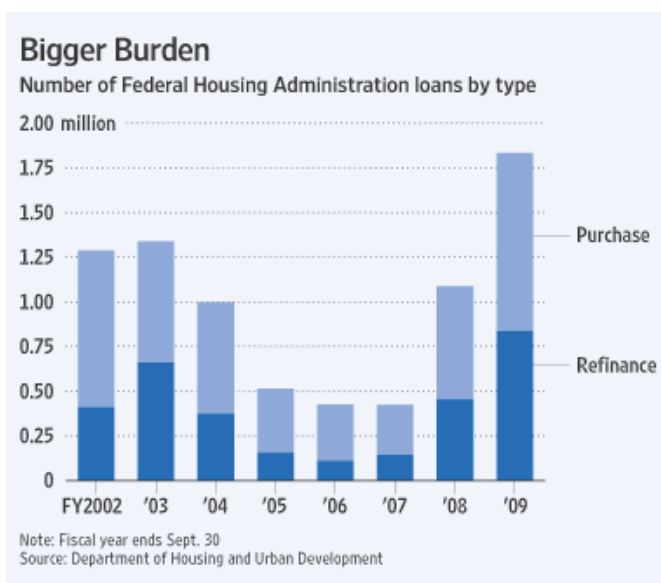
By NICK TIMIRAOS

Last fall, as the financial system was teetering and the biggest banks were tightening credit, Karen DeForte couldn't find a lender to refinance the two mortgages on her New York home, until she received a phone call from Lend America.

Most banks rejected Ms. DeForte because her debt level was too high and her credit score too low. But Lend America put Ms. DeForte into a \$402,000 loan backed by the Federal Housing Administration, a New Deal-era agency that Washington and Wall Street were relying upon to pick up the slack in the mortgage market as private lenders pulled back. Ms. DeForte fell behind on payments six months later and is seeking a loan modification. Taking the loan was "a stupid mistake," the 46-year-old office manager said.

In late 2007 and early 2008, thousands of borrowers with marginal credit were allowed to refinance via the government-insured FHA program, just as home-price declines began to accelerate. Policy makers were urging the agency to fill the gap left by the exit of private lenders, refinancing subprime borrowers out of loans that threatened to reset to unaffordable payments.

Although the FHA has tightened credit standards, many of the 2007 and early 2008 mortgages are going bad. The agency expects defaults on **24% of all loans insured in 2007**, and **20% of those backed in 2008**. "The orders from Congress and us were clear: We want to save as many families as we can, recognizing that a lot of loans people were looking to refinance out of should never have been made in the first place," said Brian Montgomery, who served as the agency's commissioner for four years ending in July.



This month, the FHA is to release the findings of its annual audit, which will show that the projected value of the agency's reserves has fallen below a federally mandated level, raising concerns that the FHA may need taxpayer money for the first time in its 75-year history. FHA officials say the agency has enough capital to withstand expected losses.

The report is likely to reignite a debate over how aggressively the government should move to prop up the housing market by providing a steady source of mortgages that require little money down. The FHA, which doesn't make loans but insures lenders against losses if a borrower defaults, is guaranteeing half of all home-purchase loans

in some of the nation's hardest-hit housing markets. That is helping to heal housing markets but puts taxpayers at risk if home-price declines resume.

Refinance loans are hitting the FHA hard. While delinquencies on refinance loans have been lower than those for purchases, that began to change in 2006, and delinquencies on refinance loans have risen faster than those on new loans in the past three years, according to First American CoreLogic.

The FHA began to take on riskier loans in 2007. **By the end of 2007, the share of borrowers with credit scores of less than 600 had grown to 37%, up from 30% a year earlier**, according to LPS Applied Analytics. The FHA says it is insuring better loans today, but that is primarily because lenders that originate FHA-backed loans began instituting their own minimum standards in 2008, several months after FHA volume surged. Average credit scores have jumped by nearly 70 points, to around 690.

David Stevens, a mortgage-industry veteran who became FHA commissioner in July, has moved aggressively to kick out lenders that the FHA blames for taking advantage of the government program. "What we have to do is eliminate players who prey on the industry in a way that is not legitimate," Mr. Stevens said.

Last month, the Justice Department filed a civil fraud suit against Lend America of Melville, N.Y., a unit of Ideal Mortgage Bankers Ltd. that specialized in subprime lending until 2006. The suit, which cites 40 cases of alleged mortgage fraud committed by the company against the FHA, is seeking \$14 million in claims against the mortgage bank. Executives of the company, which is fighting the suit, weren't available to comment.

**Write to** Nick Timiraos at [nick.timiraos@wsj.com](mailto:nick.timiraos@wsj.com)

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