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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-207448

OCTOBER 24, 1983

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The Honorable Jake Garn
Chairman, Subcommittee on
HUD-Independent Agencies
Committee on Appropriations
United States Senate

Subject: Mortgages Assigned to the Department of Housing and Urban Development Under Section 221(g)(4) of the National Housing Act (GAO/RCED-84-40)

Dear Mr. Chairman:

As requested, this report transmits information provided in our June 30, 1983, briefing regarding the potential long-term costs to the Department of Housing and Urban Development (HUD) because of the provisions contained in Section 221(g)(4) of the National Housing Act [12 U.S.C. §17151(g)(4)]. Enclosure I contains details on the results of our work and an explanation of our objectives, scope, and methodology.

Legislation, enacted in 1954 as part of section 221 of the National Housing Act, allows mortgagees holding mortgages insured under section 221 to assign them to HUD, if they are not delinquent and are at least 20 years old but not more than 21 years old, in exchange for interest bearing debentures (i.e., registered, transferable securities which are federally guaranteed obligations with respect to the payment of principal and semi-annual interest). Because the section 221(g)(4) provision allows mortgagees to obtain debentures bearing current interest rates in return for mortgages bearing 20-year old rates, future costs to HUD could be substantial. For example, we estimated that HUD's net cash outlay, by the year 2013, could exceed $6.9 billion in debenture principal and interest for the existing multifamily portion of the section 221 program. At a rate of 10 percent, $887.3 million would have to be invested today to pay this estimated debt by the year 2013. The 10 percent rate represents outstanding yield on government securities, which is consistent with our period of analysis.

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Legislative changes have been proposed in the Senate version of HUD's 1983 housing authorization bill S. 1338 to eliminate the assignment provision in future section 221 insurance contracts. Similar provisions, however, are not included in the House bill (H.R. 1).

As arranged with your office, we will make copies of this report available to all interested parties.

Sincerely yours,

J. Dexter Peach
Director

Enclosure

Contents

ABBREVIATIONS

GAO	General Accounting Office
GNMA	Government National Mortgage Association
HUD	Department of Housing and Urban Development

SECTION 221(g)(4) OF THE NATIONAL HOUSING ACT - COST IMPLICATIONS TO THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective was to ascertain the potential cost impact to the Department of Housing and Urban Development (HUD) because of the mortgage assignment provision of section 221(g)(4) [12 U.S.C. §17151(g)(4)] of the National Housing Act. In this connection, we reviewed current and proposed legislation and related legislative history, regulations, budget data, and other documents obtained from HUD. We also interviewed HUD and Government National Mortgage Association (GNMA) officials to discuss the implications of the 221(g)(4) provisions in terms of cost and need. Also, because HUD had not, at the time of our review, made independent estimates of the future costs of the 221(g)(4) provision, we made our own estimates of the potential costs through the year 2013. In doing this, we utilized historical insurance in force and default statistics provided by HUD, current HUD budget estimates, and mortgage inventory data obtained from GNMA. In concert with these cost estimates, we also computed the appropriate present value to ascertain what would have to be invested today in order to pay off the estimated debt by the year 2013.

We performed our review in accordance with generally accepted government auditing standards with the exception of obtaining official agency comments. As requested by your office, we waived this requirement.

WHAT IS SECTION 221?

Section 221 of the National Housing Act of 1934 [12 U.S.C. §1701 et seq.], as amended, gives HUD the authority to insure mortgages for single- and multifamily housing for low- and moderate-income persons. As of September 30, 1982, insurance in force for the various section 221 programs was estimated by HUD to be, as follows:

Section of the act	Type of housing: Single (1 to 4 family properties)	Type of housing: Multifamily (more than 4 family properties)	Description	Estimated insurance in force-9/30/82
				(millions)
221(d)(2)	X		Housing for low- and moderate-income and displaced persons	$ 5,853
221(h)	X		Sales housing[a]	14
221(d)(3) & (d)(4)		X	Rental housing for low- and moderate-income persons	15,912
221(h)		X	Sales and rehabilitation sales projects[a]	6
Estimated insurance in force - 9/30/82				$21,785

[a]Housing which is built in blocks and then sold off individually by builders. Program is no longer active as far as new insurance.

According to information obtained from representatives of HUD's Office of Budget and Economic Analysis, Assistant Secretary for Housing, and confirmed by HUD's fiscal year 1984 budget estimates, section 221 mortgage insurance activity is expected to continue into the foreseeable future. For example, HUD has estimated that it will receive applications for about 47,000 units under the multifamily portion of the section 221 program in fiscal year 1984.

HOW MORTGAGE INSURANCE WORKS AND WHAT MAKES SECTION 221 DIFFERENT

Ordinarily, when HUD provides mortgage insurance, the mortgagee (i.e., lending institution) pays mortgage insurance premiums and services the mortgage, including the collection of principal, interest, and other fees, over the life of the mortgage (normally 40 years) unless a default occurs. In the event of default, HUD pays the mortgagee's claim (i.e., unpaid principal balance of the mortgage and any applicable costs) and either acquires the property for sale or becomes the assigned mortgagee.

Section 221 mortgages, however, can differ in that section 221(g)(4) provides mortgagees with the option to assign mortgages insured under section 221 to HUD if they are not delinquent after 20 years from mortgage insurance endorsement (but no later than the end of the 21st year). In return for the assignment of the mortgage, HUD pays the mortgagee with a debenture (1) in the amount of the unpaid mortgage plus accrued interest, (2) payable at par in 10 years, and (3) bearing interest at the going federal rate as determined at the time of issuance. Since July 1, 1980, this rate has ranged from 9-3/8 percent to 12-1/2 percent and, as of July 1, 1983, is 9-3/8 percent. At these rates, holders of 20-year old section 221 mortgages can profit by turning them in to HUD in return for the higher yield debentures.

The section 221(g)(4) assignment option was included in the 1954 legislation as a means to ". . .encourage private funds for section 221 projects. . .."[1] However, given today's high interest rates, current HUD and GNMA officials expressed similar opinions that the provision is not particularly helpful or necessary as an inducement for housing production. They further stated that in the long term, the provision will be extremely costly to HUD.

<u>POTENTIAL COSTS OF
221(g)(4) ASSIGNMENTS</u>

Because the multifamily portion of the section 221 program was not in full swing until the mid-1960's and early 1970's, HUD is just starting to get a trickle of 221(g)(4) assignments. By May 1983, for example, only two multifamily assignments had been made under 221(g)(4). One of these--a claim for almost $2.7 million--will cost HUD over $5.6 million in debenture principal and interest by 1991 (excluding revenue which HUD may realize through subsequent resale or payment of the mortgage).

Overall, we estimated that, for over 7,100 active section 221 multifamily projects insured from fiscal year 1962 to fiscal year 1982, HUD's net cash outlay by the year 2013 could exceed $6.9 billion[2] in debenture principal and interest. These costs were estimated by computing the potential payments in debenture principal and interest through the year 2013[3] for all section 221

[1]Housing Act of 1954, S. Rept. 1472, May 28, 1954, p. 2748.

[2]Our estimate is based on assumptions further described on page 7 concerning numerous variables used in computations.

[3]Mortgagees have until the 21st year to decide whether they will assign mortgages (24 C.F.R. §221.775).

multifamily mortgages insured from fiscal years 1962 to 1982 and still in force at February 3, 1983, and adjusting with estimates for (1) defaults prior to the 20th year, (2) GNMA inventories which, by agreement with the HUD Secretary, will not be assigned or sold, (3) sales of assigned mortgages, and (4) investment income from proceeds of assigned mortgage sales. Our estimates could not reasonably consider fluctuations in future interest rates; revenue collections before resale of assigned mortgages; prepayments before expiration of 20 years; or the extent to which eligible mortgages will not be assigned because mortgagees (1) are not familiar with the 20-year assignment provision, (2) perceive retention of the mortgage as a better investment opportunity, or (3) are not attracted by the prospect of receiving 10-year debentures. At the time we performed our work, HUD had not developed its own independent estimates of the potential future costs of the 221(g)(4) assignment provision for multifamily housing and, thus, could not disclose any contingency for such costs in its fiscal year 1984 budget. The $6.9 billion in potential cash outlay by HUD was estimated by us, as shown on the next page.

Potential Costs of 221(g)(4) Provision Through the Year 2013 - Multifamily

(millions)

Estimate of gross costs to HUD by the year 2013 in debenture principal because of assignments of multifamily mortgages under section 221(g)(4)[a]		$11,257.0
Less adjustments to gross costs: Estimated defaults[b]	$1,044.9	
Estimated value of GNMA-held mortgages which, per agreement with HUD, cannot be assigned or sold[c]	362.5	1,407.4
Estimated value of mortgages available for sale after assignment under 221(g)(4)		9,849.6
Less: estimated sales price of assigned mortgages (@64.8 percent of assigned value)[d]		6,382.5
Estimated net outlay by HUD to pay off debentures by the year 2013		3,467.1
Estimated net interest on debentures @10 percent for 10 years[e]		3,467.1
Estimated net cash outlay by the year 2013		$ 6,934.2[f]

[a]Based on project inventory data provided by HUD as of February 3, 1983.

[b]Based on recent section 221 default trends.

[c]Based on actual GNMA holdings at 9/30/82.

[d]Based on HUD's estimate of anticipated losses on sales of assigned multifamily mortgages on hand as of 9/30/82.

[e]For computation purposes we assumed a 10-percent rate for both debenture interest and investment income from proceeds of assigned mortgage sales. Accordingly, interest was computed only on the difference between debenture payouts and sales of assigned mortgages.

[f]At an investment rate of 10 percent, $887.3 million would have to be invested today to pay the estimated debt by 2013. The 10 percent rate represents outstanding yield on government securities which is consistent with our period of analysis.

Future costs for the single-family portion of the section 221 program could also be significant. However, potential cost impact would not be as great as for multifamily projects because (1) many single-family loans will be prepaid prior to becoming eligible for assignment after 20 years, (2) the shorter term of single-family mortgages (e.g., 30 years or less versus 40 years for multifamily mortgages) could make assignment after 20 years in return for a 10-year debenture an unacceptable investment risk, and (3) insurance in force is not as substantial. (See p. 4.)

Because the section 221(g)(4) provision allows mortgagees to obtain debentures bearing current interest rates in return for mortgages bearing 20-year old rates, future costs to HUD could be substantial as shown by the above estimate. Further, as more insurance continues to be written for the section 221 program, the prospect for even greater future costs exists. The extent of these costs, while unpredictable at this time, would depend on a multitude of future economic variables, including (1) mortgage interest rates, (2) debenture interest rates, (3) default trends, and (4) the extent that HUD recaptures its costs through the sales of assigned mortgages. These costs would be absorbed by HUD's General Insurance Fund. This fund is one of HUD's four mortgage insurance funds and, at September 30, 1982, had a deficit of over $2.4 billion.

The section 221(g)(4) assignment provision could also increase HUD's administrative costs because of the increased staff that would be required to receive, service, and dispose of the assigned mortgages. The Senate version of HUD's 1983 housing authorization bill (S. 1338) includes a proposed legislative amendment which would give GNMA, as agent for HUD, the authority to receive, service, and sell these assigned mortgages. Passage of this amendment would help alleviate HUD's administrative burden although HUD would reimburse GNMA for appropriate administrative costs.

PROPOSED REMEDIES TO AVOID FUTURE COSTS

HUD has proposed legislation to amend the section 221(g)(4) provision of the National Housing Act in both fiscal years 1982 and 1983. HUD's proposals were designed to eliminate the "buy-back" feature with respect to commitments to insure section 221 mortgages entered into after passage of the legislation. Because HUD's 1982 housing authorization bill (S. 2361), 97th Congress, 2nd session, did not pass, the proposal was included in the 1983 housing authorization bill (S. 644). The proposal remains in the revised version of HUD's 1983 housing authorization bill (S. 1338). However, it is not included in the House bill (H.R. 1).