



Highlights of [GAO-06-868T](#), a testimony before the Subcommittee on Housing and Transportation, Committee on Banking, Housing, and Urban Affairs, United States Senate

Why GAO Did This Study

The Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) has faced several challenges in recent years, including rising default rates, higher-than-expected program costs, and a sharp decline in program participation. To help FHA adapt to market changes, HUD has proposed a number of changes to the National Housing Act that would raise FHA's mortgage limits, allow greater flexibility in setting insurance premiums, and reduce down-payment requirements. Implementing the proposed reforms would require FHA to manage new risks and estimate the costs of program changes. To assist Congress in considering issues faced by FHA, this testimony provides information from recent reports GAO has issued that address FHA's risk management and cost estimates. Specifically, this testimony looks at (1) FHA's development and use of its mortgage scorecard, (2) FHA's consistent underestimation of program costs, (3) instructive practices for managing risks of new mortgage products, and (4) weaknesses in FHA's management of risks related to loans with down-payment assistance.

www.gao.gov/cgi-bin/getrpt?GAO-06-868T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

FEDERAL HOUSING ADMINISTRATION

Proposed Reforms Will Heighten the Need for Continued Improvements in Managing Risks and Estimating Program Costs

What GAO Found

Recent trends in mortgage lending have significantly affected FHA, including increased use of automated tools (e.g., mortgage scoring) to underwrite loans, increased competition from lenders offering low-and no-down-payment products, and a growing proportion of FHA-insured loans with down-payment assistance. Although FHA has taken steps to improve its risk management, in a series of recent reports, GAO identified a number of weaknesses in FHA's ability to manage risk and estimate program costs during this period of change. For example:

- The way that FHA developed and uses its mortgage scorecard, while generally reasonable, limits how effectively it assesses the default risk of borrowers.
- With one exception, FHA's reestimates of program costs have been less favorable than originally estimated, including a \$7 billion reestimate for fiscal year 2003.
- FHA has not consistently implemented practices used by other mortgage institutions to help manage the risks associated with new mortgage products.
- FHA has not developed sufficient standards and controls to manage risks associated with insuring a growing proportion of loans with down-payment assistance.

GAO made several recommendations in its recent reports, including that FHA (1) incorporate the risks posed by down-payment assistance into its mortgage scorecard, (2) study and report on the impact of variables not in its loan performance models that have been found to influence credit risk, and (3) consider piloting new mortgage products. FHA has taken actions in response to GAO's recommendations, but additional improvements in managing risk and estimating program costs will be important if FHA is to successfully implement its proposed program changes.