



Highlights of [GAO-07-708](#), a report to congressional requesters

Why GAO Did This Study

In recent years, the Federal Housing Administration (FHA) has experienced a sharp decline in market share. Also, the agency has estimated that, absent program changes, its Mutual Mortgage Insurance Fund (Fund) would require appropriations in 2008. To adapt to market changes, FHA has implemented new procedures and proposed the following major legislative changes: raising FHA's loan limits, allowing risk-based pricing, and lowering down-payment requirements. GAO was asked to report on (1) the likely program and budget impacts of FHA's modernization efforts; (2) the tools, resources, and risk-management practices important to FHA's implementation of the legislative proposals, if passed; and (3) other options that FHA and Congress could consider to help FHA adapt to market changes. To address these objectives, GAO analyzed FHA and Home Mortgage Disclosure Act (HMDA) data and interviewed officials from FHA and other mortgage institutions.

What GAO Recommends

While making no new recommendations, GAO re-emphasizes the need for continued management attention to prior GAO recommendations that could help address risks and challenges associated with the legislative proposals. HUD commented that the report's concerns about FHA's risk management and emphasis on the need for piloting new products were unwarranted.

www.gao.gov/cgi-bin/getrpt?GAO-07-708.

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

Modernization Proposals Would Have Program and Budget Implications and Require Continued Improvements in Risk Management

What GAO Found

FHA's recent changes to insurance approval and appraisal requirements have streamlined its insurance process, and FHA's major legislative proposals could affect the demand for FHA's loans, the cost and availability of insurance to borrowers, and the insurance program's budgetary costs. Based on GAO's analysis of HMDA data, the number of FHA-insured loans could have been from 9 to 10 percent greater in 2005 had the higher, proposed mortgage limits been in effect. GAO's analysis of data on 2005 FHA home purchase borrowers shows that 43 percent would have paid the same or less under the risk-based pricing proposal than they actually paid, 37 percent would have paid more, and 20 percent (those with the highest expected claim rates) would not have qualified for FHA insurance. While to be viewed with caution, FHA has made estimates indicating that the loans it expects to insure in 2008 would result in negative subsidies (i.e., net cash inflows) of \$342 million if the major legislative changes were enacted, rather than requiring an appropriation of \$143 million absent any program changes.

FHA has taken or planned steps to enhance tools and resources and adopt risk-management practices important to implementing the legislative proposals, but does not intend to use a common industry practice, piloting, to mitigate the risks of any zero-down-payment product it is authorized to offer. In response to prior GAO recommendations, FHA has taken steps to improve the loan performance and scoring models it would use in risk-based pricing. It also has identified minor changes to its information systems and staff increases needed to implement the proposals but faces long-term challenges in these areas. Additionally, the legislative proposals would introduce new risks. The proposal to lower down-payment requirements is of particular concern given the higher default rates on these loans and the difficulty of setting prices for new products whose risks may not be well known. GAO has previously indicated that Congress may want to consider requiring FHA to limit the initial availability of any new products and also recommended that FHA itself consider piloting. However, FHA has indicated that it does not plan to pilot any no-down-payment product it might offer.

Mortgage industry participants and researchers have suggested more options that Congress and FHA could consider to help FHA adapt to changes in the mortgage market, but some changes could have budget impacts and complicate oversight efforts. Some administrative changes—such as implementing a more limited form of risk-based pricing—are within FHA's existing authority. Congress also could grant FHA additional authority that would allow it to invest the Fund's current resources in information technology and human capital, but this would increase the federal government's budget deficit. Finally, Congress could contemplate other approaches to the provision of federal mortgage insurance, such as creating a government corporation. However, any fundamental changes to how the federal government provides mortgage insurance could require new oversight mechanisms and would require careful deliberation.