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Highlights

Highlights of GAO-07-1109T, a testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

July 18, 2007

FEDERAL HOUSING ADMINISTRATION

Proposed Legislative Changes Would Affect Borrower Benefits and Risks to the Insurance Funds

Why GAO Did This Study

Fewer borrowers are using the Federal Housing Administration's (FHA) single-family and manufactured housing insurance programs. To help counter this trend, proposed changes to the single-family program would raise loan limits, allow risk-based pricing of premiums, and reduce down payments. Changes such as higher loan limits also were proposed for the manufactured housing program. To assist Congress in considering the impact of these changes, this testimony provides information from recently issued GAO reports and preliminary views from ongoing work. Specifically, GAO discusses (1) trends in FHA's share of the mortgage market, (2) likely impacts of proposed changes to the single-family program, (3) practices important to implementing the changes to the single-family program, if passed, and (4) preliminary observations from our work on the manufactured housing program. To conduct this work, GAO analyzed agency, Home Mortgage Disclosure Act, and Census data and interviewed agency and lending industry officials and other stakeholders.

What GAO Recommends

While making no new recommendations, GAO reemphasizes the need for continued management attention to prior GAO recommendations that could help address risks and challenges associated with the single-family legislative proposals.

www.gao.gov/cgi-bin/getrpt?GAO-07-1109T.

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.

What GAO Found

FHA's share of the single-family mortgage market declined 13 percentage points from 1996 through 2005, with conventional lenders gaining notably increased percentages of lower-income and minority borrowers. This decline in market share was associated with a number of factors, including FHA's product restrictions and product innovations in the conventional market.

The proposed changes to the single-family program could affect borrowers as well as program costs. For example, GAO estimated that in 2005 FHA could have insured 9 to 10 percent more loans if proposed mortgage limits were in effect. But, if the risk-based pricing proposal had been in effect in 2005, 20 percent of borrowers would not have qualified for FHA insurance. FHA determined that the expected claim rates of these borrowers were higher than it found tolerable for either the borrower or the Mutual Mortgage Insurance Fund. Absent any program changes, FHA estimates that the fund would require an appropriation of approximately $143 million in fiscal year 2008. If proposed changes were passed, FHA estimates that the fund would generate $342 million in negative subsidies (i.e., net cash inflows).

Although FHA is taking steps to enhance tools important to implementing the proposed changes to its single-family program, it does not plan to use a common industry practice, piloting, to mitigate the risks of any zero-down-payment product. In response to prior GAO recommendations, FHA improved its loan performance models and is refining its mortgage scorecard (which evaluates the default risk of borrowers). However, the proposals would introduce new risks and challenges. The proposal to lower down payments is of particular concern given the greater default risk of these loans and the difficulty of setting prices for new products whose risks may not be well understood. One of the ways FHA plans to mitigate new or increased risks is through stricter underwriting standards, but it does not plan to pilot any zero-down-payment product. Other mortgage institutions use pilots to manage risks associated with changing or expanding product lines.

Proposals for the manufactured home loan program would increase loan limits, insure each loan made, incorporate stricter underwriting requirements, and set premium rates. While the changes could benefit borrowers, according to FHA and the Congressional Budget Office, the potential costs could expand the government's liability. However, FHA has not articulated which borrowers would be targeted if the program were expanded, specified changes in its underwriting requirements, developed a risk-based pricing structure for the proposed legislation, or estimated costs to the General Insurance Fund. As a result, the potential effects of the changes on the program and the insurance fund are unclear.