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Report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Banking and Financial Services, House of Representatives

August 1996

HOMEOWNERSHIP

FHA's Role in Helping People Obtain Home Mortgages

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The Honorable Rick Lazio
Chairman
Subcommittee on Housing
and Community Opportunity
Committee on Banking and
Financial Services
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review the role of the Federal Housing Administration (FHA) in providing mortgage credit to home buyers. Specifically, the report discusses (1) the terms of the mortgage insurance offered by FHA, private mortgage insurers, and the U.S. Department of Veterans' Affairs; (2) the characteristics of borrowers of insured mortgages and the overlap between FHA-insured mortgages and privately insured mortgages; and (3) other methods used by the federal government to promote affordable homeownership.

We are sending copies of this report to the Secretaries of Housing and Urban Development, Agriculture, and Veterans Affairs; the Chairman of the Federal Housing Finance Board; the Presidents of the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation; and the President of the Mortgage Insurance Companies of America. We will make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix VII.

Sincerely yours,

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Executive Summary

Purpose

Many changes have occurred in the single-family housing finance system since the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) was established in 1934 to insure housing loans made by private lenders. These changes include the advent of modern private mortgage insurance, the development of a secondary mortgage market, and the emergence of a number of public- and private-sector initiatives designed to expand affordable housing opportunities for home buyers. Given these developments, recent debate and legislative proposals have centered on whether there is still a need for FHA's single-family mortgage insurance program and, if so, what changes need to be made to the program. Critics of FHA contend that other housing finance players, such as the private mortgage insurers, are filling the need once filled exclusively by FHA. Supporters of FHA argue that its single-family program, which has insured about 24 million home mortgages since its inception, remains the only way for some families to become homeowners and should be expanded.

To obtain more information about the role of FHA's single-family program in today's housing finance system, the Chairman of the Subcommittee on Housing and Community Opportunity, House Committee on Banking and Financial Services, asked GAO to address three questions: (1) How do the insurance terms available through FHA's primary single-family mortgage insurance program compare with private mortgage insurance and guaranties from the U.S. Department of Veterans' Affairs (VA)? (2) How many of the home buyers in 1994 used FHA insurance, what are the characteristics of these home buyers, and how many of them might also qualify for private mortgage insurance? (3) What other federal activities promote affordable homeownership?

Background

About 6 million borrowers took out mortgages in 1994 for purchasing homes and for refinancing existing mortgages, according to information collected through the Home Mortgage Disclosure Act.[1] About 32 percent of these mortgages were insured. Lenders usually require mortgage insurance when a home buyer has a down payment of less than 20 percent of the value of the home. In these cases, the loan-to-value ratio of the mortgage—the mortgage amount as a percentage of the value of the home—is higher than 80 percent. Most lenders require mortgage insurance for these loans because they are more likely to default than loans with lower loan-to-value ratios. If a loan with mortgage insurance defaults, the

[1]This figure is based on mortgages reported by lenders through the Home Mortgage Disclosure Act. However, the number of mortgages written in 1994 is somewhat higher because the Home Mortgage Disclosure Act collects information on most but not every mortgage.

lender may foreclose on the loan and collect all or a portion of the losses from the insurer.

Virtually all single-family mortgage insurance is provided by private mortgage insurers, FHA, and VA. In general, private mortgage insurers operate standard programs for typical borrowers and special affordable programs for qualified borrowers who have fewer down payment funds and need increased underwriting flexibility.[2] FHA provides most of its single-family mortgage insurance through the Section 203(b) program. The Section 203(b) program has not required any federal funds to operate because FHA has collected enough revenue from insurance premiums and foreclosed property sales to cover claims and other expenses. FHA also operates some smaller, specialized single-family mortgage insurance programs. A primary goal of FHA's single-family programs is to assist households who may be underserved by the private market. VA provides insurance through its Home Loan Guaranty Program.[3]

FHA, VA, and the private mortgage insurers provide lenders with guidelines for deciding whether or not a mortgage is eligible for mortgage insurance. In addition, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—government-sponsored enterprises that provide a secondary market for many home mortgages—establish their own guidelines for the loans they will purchase. A borrower's ability to repay the mortgage is often evaluated by computing ratios of the borrower's total debt burden and housing expenses to his/her income (referred to as "qualifying ratios"). The "total-debt-to-income ratio" compares all of the borrower's long-term debt payments, including his/her housing expenses, with his/her income. The "housing-expense-to-income ratio" compares the borrower's expected housing expenses with his/her income.

GAO was unable to distinguish loans insured through FHA's Section 203(b) program from loans insured through FHA's smaller single-family mortgage insurance programs in the Home Mortgage Disclosure Act database and other automated data sources. Consequently, sections of this report on FHA's market share, the characteristics of FHA borrowers, and the borrowers who may have qualified for private mortgage insurance pertain

[2]Underwriting is the process of analyzing a borrower's willingness and ability to repay a loan.

[3]Although VA actually guarantees mortgages rather than insuring them, this report uses the term "mortgage insurance" to refer to the mortgage guaranty provided by VA as well as the mortgage insurance provided by FHA and the private mortgage insurers. VA's guaranty is available only to U.S. veterans and their families.

to all single-family loans insured by FHA. Other sections of the report provide separate information on FHA's Section 203(b) program.

Results in Brief

The FHA and VA programs permit borrowers to make smaller down payments and have higher total-debt-to-income ratios than allowed by private mortgage insurers. FHA's program differs from both the private mortgage insurers' and VA's programs in that it allows closing costs to be financed in the mortgage, insures loans only up to a maximum amount of $155,250, and provides nearly full insurance coverage to lenders.

FHA is a major participant in the single-family housing market. Of the approximately 3.5 million home purchase loans made in 1994, FHA insured 15 percent. FHA insured 35 percent of the insured home purchase loans and fulfilled an even larger role in some specific market segments, particularly low-income home buyers and minorities.[4] However, more of the home purchase loans to all borrowers (and to low-income borrowers and minorities) were uninsured than were insured by either FHA, the private mortgage insurers, or VA. In addition to insuring a major portion of loans made nationwide in 1994, FHA insured more home purchase mortgages than did the private mortgage insurers or VA in at least nine states. While about a third of the loans FHA insured in 1995 might have qualified for private mortgage insurance, the other two-thirds probably would not have qualified, on the basis of the loan-to-value and qualifying ratios of the loans FHA insured.

Although a number of other federal programs share FHA's mission to assist households who may be underserved by the private market, none reach as many households as FHA. In addition to FHA and VA, the federal government promotes affordable homeownership through programs run by HUD, the Department of Agriculture's Rural Housing Service, the Federal Home Loan Bank System, state housing finance agencies, and the Neighborhood Reinvestment Corporation. Unlike FHA's Section 203(b) program, over half of these other programs require direct federal funds. Several of these other programs assist home buyers by combining their assistance with FHA mortgage insurance. The federal government also promotes homeownership among home buyers who might otherwise be underserved through requirements placed upon Fannie Mae, Freddie Mac, and certain lenders.

[4]"Low-income" refers to a borrower with an income no greater than 80 percent of the median income in the Metropolitan Statistical Area where the borrower is located.

GAO's Analysis

Mortgage Insurance Terms Offered by FHA Differ From Those of Private Mortgage Insurers and VA

The mortgage insurance programs of FHA, the private mortgage insurers, and VA differ in terms of maximum loan-to-value ratios and mortgage amounts, the financing of closing costs, and the amount that each will pay lenders to cover the losses associated with foreclosed loans, according to the guidance prepared by the insurers for lenders. While both FHA and VA can insure loans with effective loan-to-value ratios that exceed 100 percent (due to the financing of closing costs or other fees), the private mortgage insurers do not offer insurance for loans with loan-to-value ratios greater than 97 percent. In addition, FHA insures loans only up to a maximum of $155,250, while the private mortgage insurers and VA permit insurance of larger loans. In connection with settlement costs, FHA allows borrowers to finance most closing costs, but private mortgage insurers and VA do not. However, both FHA and VA allow borrowers to finance their insurance premiums. Finally, while FHA protects lenders against nearly 100 percent of the loss associated with a foreclosed mortgage, the private mortgage insurers and VA limit their coverage to a portion of the mortgage balance. Private mortgage insurers generally cover only 20 to 35 percent and VA covers only 25 to 50 percent of the mortgage balance, even if a loss exceeds that amount.

Although GAO found some variation in the qualifying ratios of FHA, the private mortgage insurers, and VA, the guidance provided by the insurers showed few other clear differences in the underwriting standards for borrowers. Each of the insurers permits the lenders to consider compensating factors, such as a large down payment, when a borrower does not meet the qualifying ratios. In addition, although lenders must apply established credit standards, each of the insurers relies on the individual judgment and interpretation of the lenders in evaluating the credit history of borrowers.

FHA Was the Primary Insurer for Low-Income and Minority Home Buyers

GAO's analysis of data available through the Home Mortgage Disclosure Act and through the Mortgage Insurance Companies of America showed that FHA insured 15 percent of all home purchase loans made in 1994 and an even larger portion of the loans made to low-income home buyers and minorities. FHA served 20 percent of all the low-income home buyers and 24 percent of all the minority home buyers in 1994. Furthermore, mortgages for low-income and minority home buyers constituted a greater

portion of FHA's 1994 business than they did for private mortgage insurers or VA, as shown in table 1.

Table 1: Low-Income and Minority Home Buyers in 1994, by Type of Mortgage Insurance

	Low-income home buyers		Minority home buyers	
	Number of households served[a]	Percentage of insurer's business[b]	Number of households served[a]	Percentage of insurer's business[b]
FHA	220,000	42	147,000	28
Private mortgage insurers	178,000	25	114,000	16
VA	74,000	34	48,000	22

[a]Number of households rounded off to the nearest thousand.

[b]Figures are based on all home purchase loans insured by either FHA, private mortgage insurers, or VA during 1994.

Source: GAO's analysis of data obtained through the Home Mortgage Disclosure Act and Mortgage Insurance Companies of America.

In addition, FHA insured more home purchase loans than the private mortgage insurers combined in at least nine states—Arkansas, Maryland, Minnesota, Montana, Nevada, North Dakota, Oklahoma, Tennessee, and Utah—even though private mortgage insurance companies insured far more home purchase loans overall than FHA in 1994 (about 725,000 and 519,000, respectively).

Although FHA was a major participant in the housing market in 1994, 58 percent of all home buyers used no mortgage insurance. In addition, a similarly large portion of the low-income home buyers and the minority home buyers in that year used no mortgage insurance (57 percent and 49 percent, respectively).

On the basis of the loan-to-value and qualifying ratios of their FHA-insured mortgages and the maximum ratios generally permitted by private mortgage insurers, about 34 percent of the home buyers who used FHA insurance in 1995 may have qualified for private insurance for the loans they received. Conversely, about 66 percent of the loans insured by FHA in 1995 would probably not have qualified for private mortgage insurance. These loans had loan-to-value ratios above the private mortgage insurance maximum of 97 percent, had housing-expense-to-income ratios above the private mortgage insurance maximum of 33 percent, or had

total-debt-to-income ratios above the private mortgage insurance maximum of 38 percent. Looking exclusively at the first-time home buyers who took out FHA loans in 1995, 77 percent would not have met the private mortgage insurers' loan-to-value and qualifying ratio standards. An even greater portion (85 percent) of the low-income FHA borrowers would not have met the private mortgage insurers' standards.

Other Federal Activities Promote Affordable Homeownership

The federal government is involved in many other efforts to make homeownership affordable. HUD operates three grant programs—the Community Development Block Grant program, the HOME Investment Partnership program, and Housing Opportunities for People Everywhere—that promote affordable homeownership. The Federal Home Loan Bank System has its Affordable Housing Program and Community Investment Program, which provide subsidies, subsidized advances, or other advances to member institutions to be used to fund affordable housing projects and loans to home buyers. The Department of Agriculture's Rural Housing Service operates a subsidized direct loan program for low-and very-low-income rural Americans and a guaranteed loan program for moderate-income rural Americans. The state housing finance agencies, through the use of tax-exempt mortgage revenue bonds, provide financing for affordable homeownership. The Neighborhood Reinvestment Corporation, through its network of local development organizations and its secondary market organization, promotes affordable homeownership primarily through second mortgages and home buyer education. These programs provide assistance in the form of grants, direct loans, guaranties, interest subsidies, and other forms.

There are several important distinctions between FHA's single-family mortgage insurance programs and these other federal programs. First, FHA serves more homeowners than the other programs combined. In 1995, almost 570,000 homeowners took out insured loans through FHA's programs. In addition, at least half of the other programs require federal funds, while FHA's Section 203(b) program does not. Furthermore, the programs are generally targeted at borrowers with low incomes or at borrowers who are otherwise underserved by the private market to a greater extent than FHA's program. FHA's Section 203(b) program is not restricted to low-income or otherwise underserved borrowers. In fact, diversifying risk by serving a wide variety of borrowers may have actually helped the program operate without federal funds, according to industry officials.

Several of the other federal programs assist low-and moderate-income home buyers by combining their assistance with FHA mortgage insurance. A substantial portion of the mortgages made through state housing finance agencies and HUD's Housing Opportunities for People Everywhere program were insured by FHA in 1994. Similarly, private mortgage insurance may also be combined with assistance from federal housing programs. For example, one private mortgage insurer that GAO reviewed provided insurance for mortgages assisted through a Neighborhood Reinvestment Corporation program.

The federal government also promotes homeownership by requiring major housing finance players to address housing finance needs. Specifically, Fannie Mae and Freddie Mac have legislatively-set goals for affordable homeownership. In addition, banks and thrifts are encouraged to lend in all areas of the communities they serve, including low- and moderate-income areas, through the Community Reinvestment Act. In addition to these requirements targeted at improving the affordability of homeownership for underserved households, the federal government also promotes homeownership for the entire general public through federal tax provisions, such as the home mortgage interest deduction.

Recommendations

GAO is making no specific recommendations because its work was limited to collecting and presenting factual information about FHA and the single-family finance system.

Agency Comments

GAO provided a draft of this report to HUD, VA, Fannie Mae, Freddie Mac, and the Mortgage Insurance Companies of America for their review and comment. GAO also provided excerpts of the draft report which pertained to their homeownership activities to the National Council of State Housing Agencies, the Federal Housing Finance Board, the Neighborhood Reinvestment Corporation, and the U.S. Department of Agriculture's Rural Housing Service. Three of the agencies—Freddie Mac, the Federal Housing Finance Board, and the U.S. Department of Agriculture's Rural Housing Service—commented that the portions of the report that discuss their agencies, with their suggested changes, were accurate. The remaining six agencies did not comment on the overall accuracy of the draft report. However, all nine agencies provided comments consisting primarily of suggested changes to technical information provided in the report and updating figures with more recent information. GAO incorporated the comments, as appropriate, throughout the report.

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Abbreviations

AHP	Affordable Housing Program
AHS	American Housing Survey
CDBG	Community Development Block Grant
CIP	Community Investment Program
CRA	Community Reinvestment Act
FHA	Federal Housing Administration
FHFB	Federal Housing Finance Board
FHLB	Federal Home Loan Bank
GAO	General Accounting Office
GSE	government-sponsored enterprise
HFA	housing finance agency
HMDA	Home Mortgage Disclosure Act
HOME	Home Investment Partnership program
HOPE	Housing Opportunities for People Everywhere
HOPE 3	Housing Opportunities for People Everywhere
HUD	Department of Housing and Urban Development
LTV	loan-to-value
MBA	Mortgage Bankers' Association
MCC	mortgage credit certificate
MICA	Mortgage Insurance Companies of America
MRB	mortgage revenue bond
MSA	Metropolitan Statistical Area
NHSA	Neighborhood Housing Services of America
NRC	Neighborhood Reinvestment Coalition
NWO	NeighborWorks organization
PHA	public housing authority
PMI	private mortgage insurer
RHS	Rural Housing Service
RTC	Resolution Trust Corporation
VA	Department of Veterans Affairs

Introduction

Purchasing a home is one of the greatest financial undertakings of most American families. In 1994, about 3.5 million families and individuals bought homes. Another 2.5 million families and individuals refinanced the mortgages on their existing homes. A variety of public- and private-sector institutions are involved in helping borrowers to obtain the mortgage credit they need to purchase homes. These institutions include mortgage insurers, who insure lenders against all or some losses on home mortgages. The primary mortgage insurers are private mortgage insurers (PMI), the Federal Housing Administration (FHA), and the U.S. Department of Veterans' Affairs (VA).[1] [2] Mortgage insurance is required primarily for borrowers with limited down payment funds.

Most Mortgages Are Not Insured

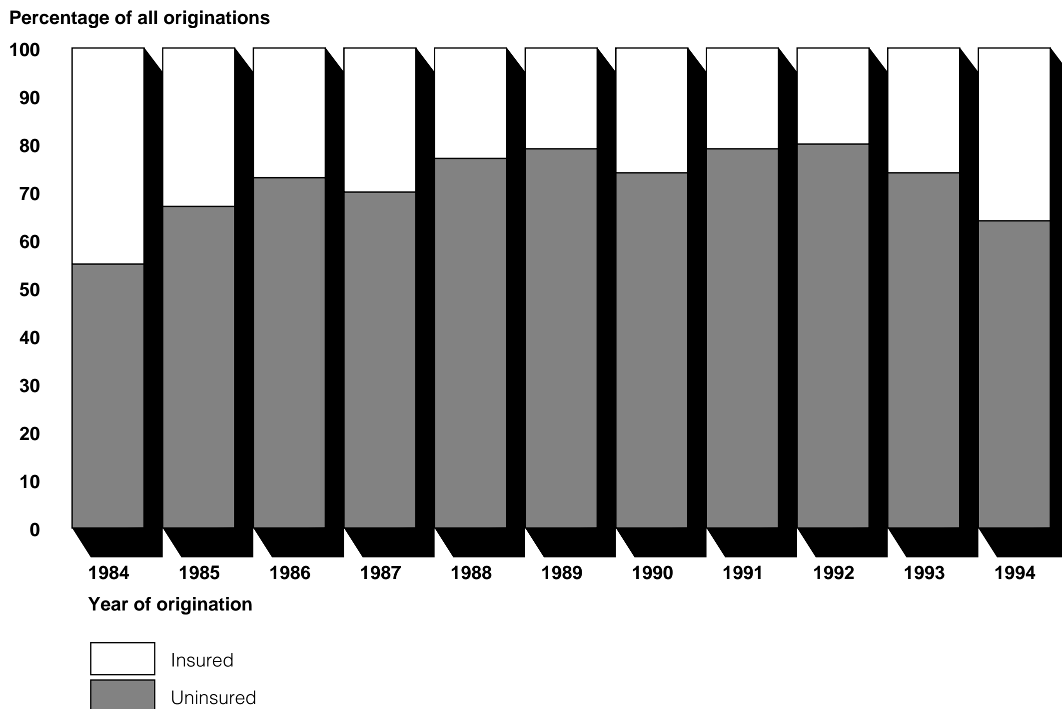
Of the approximately 6 million mortgages reported through the Home Mortgage Disclosure Act (HMDA) for purchasing homes and refinancing existing mortgages in 1994, most (4 million) were not insured. In fact, 55 percent or more of the mortgages originated[3] annually in 1984 through 1994 were uninsured. Uninsured mortgages reached their peak level in 1992 at 80 percent of all mortgages originated, as shown in figure 1.1.

[1]A small number of mortgages are insured each year through the Department of Agriculture's Rural Housing Service. In 1994, the Rural Housing Service insured less than 1 percent of all home purchase loans made.

[2]Although VA actually guarantees mortgages rather than insuring them, this report uses the term "mortgage insurance" to refer to the mortgage guaranty provided by VA as well as the mortgage insurance provided by FHA and the private mortgage insurers.

[3]Mortgage origination is the process by which a lender makes a mortgage secured by real property.

Figure 1.1: Insured and Uninsured Mortgages as a Percentage of All Mortgages Originated, 1984-94



Source: GAO's analysis of HUD's data.

Many Home Purchase Mortgages in 1994 Were Insured

Many home buyers (42 percent) who financed the purchase of a home in 1994 required mortgage insurance. This percentage is substantially higher than the percentage of all mortgages taken out for refinancing in 1994 that were insured (19 percent). Mortgage insurance is generally used when a borrower makes a down payment of less than 20 percent of the value of the home (when the mortgage has a loan-to-value (LTV) ratio greater than 80 percent). If a borrower does not repay an insured mortgage loan as agreed, the lender may acquire the property through foreclosure and file a claim with the mortgage insurer for all or a portion of its total losses (the unpaid mortgage balance and interest, along with the costs of foreclosure and other expenses). If a borrower does not have mortgage insurance and fails to repay a mortgage, the lender may acquire the property through foreclosure and is responsible for the full amount of losses it incurs.

While FHA and VA are federal entities, PMIs are privately-owned companies regulated at the state level.[4] FHA is a government corporation operated within the U.S. Department of Housing and Urban Development (HUD). However, its primary single-family mortgage insurance program, the Section 203(b) program, is supported by the Mutual Mortgage Insurance Fund, which requires no federal funds to operate. The Mutual Mortgage Insurance Fund is required by law to meet or endeavor to meet statutory capital ratio requirements; that is, it must contain sufficient reserves and funding to cover estimated future losses resulting from the payment of claims on defaulted mortgages and administrative costs. Cash flows into the fund from insurance premiums and from the sale of foreclosed property. The cash reserves in the fund have always been more than enough to cover the expenses incurred. In 1995, the fund had a negative credit subsidy of $309 million. Negative credit subsidies occur when the present value of estimated cash inflows to the government exceeds the present value of estimated cash outflows. However, if the fund were to deplete its reserves, the U.S. Treasury would have to directly cover lenders' claims and administrative costs. VA's single-family mortgage guaranty program does require federal funds each year. In 1995, this program received a credit subsidy of $684 million.[5]

Many insured single-family mortgages are ultimately sold to investors through the secondary mortgage market. In 1995, virtually all FHA- and VA-insured mortgages were sold to investors with the help of the Government National Mortgage Association (Ginnie Mae), which, like FHA, is also a part of HUD. Ginnie Mae guarantees securities backed by pools of FHA- and VA-insured mortgages. Specifically, Ginnie Mae guarantees that investors in Ginnie Mae securities will receive timely principal and interest payments. Most privately insured mortgages are sold by lenders to the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac)—two government-sponsored enterprises (GSE) that sell securities backed by pools of mortgages to investors and hold other mortgages as investments. Like Ginnie Mae, Fannie Mae and Freddie Mac guarantee investors in their securities that they will receive their expected principal and interest payments. Fannie Mae and Freddie Mac's charters require that loans they purchase with LTV

[4]The private mortgage insurance industry consists essentially of eight companies located across the U.S.: Amerin Guaranty Corporation, Commonwealth Mortgage Assurance Company, GE Capital Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Company, Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation, and United Guaranty Corporation.

[5]About $14 million of this amount is a subsidy for direct loans. The remaining $670 million is for loan guaranties.

ratios greater than 80 percent have some form of credit enhancement. Private mortgage insurance is the most common enhancement used for these high LTV loans. For an insured loan they have purchased, Fannie Mae and Freddie Mac assume the responsibility for foreclosure losses, if any, that a lender incurs above the amount of the claim paid by the PMI.

Lenders use guidelines provided by the PMIs, FHA, and VA to determine whether a borrower is eligible for mortgage insurance through any of the insurers. These guidelines include maximum allowable LTV and qualifying ratios. Although some of the guidelines pertaining to FHA and VA mortgage insurance are set by the agencies, many are set by the Congress through legislation. Similarly, although some of the requirements for private mortgage insurance originate with the PMIs, others are set by Fannie Mae and Freddie Mac. When determining if a mortgage is eligible for private mortgage insurance, the requirements set by Fannie Mae and Freddie Mac are considered because many lenders want to sell insured mortgages through the secondary market. The requirements set by Fannie Mae and Freddie Mac include underwriting standards, insurance coverage requirements, and a maximum loan amount.

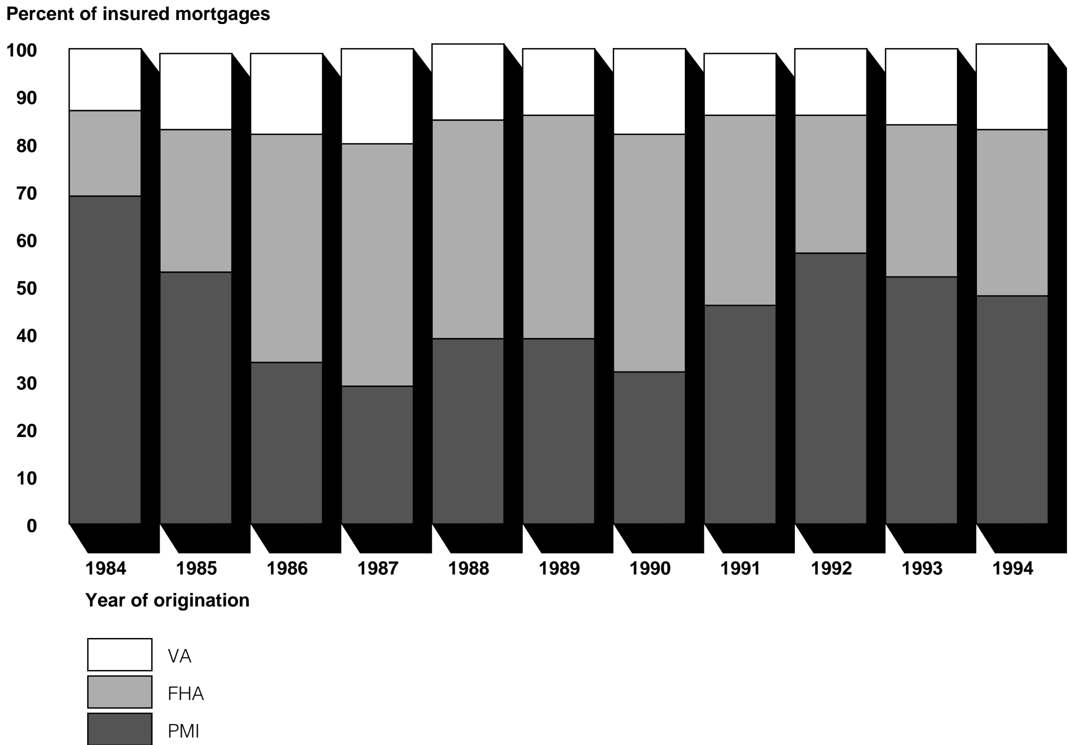
PMIs Followed FHA and VA's Lead in Providing Mortgages With Very Low Down Payments

In 1994, PMIs joined FHA and VA in offering insurance for mortgages with LTV ratios greater than 95 percent by creating special “affordable” programs. The affordable programs are for loans with LTV ratios of up to 97 percent. Generally, these affordable programs have more flexible underwriting than the standard program. Some PMIs also offer products through very specialized programs, sometimes administered in conjunction with another player, such as a state housing finance agency (HFA), with even more flexible terms than those available through the companies' affordable programs.

FHA's Share of the Insured Market Has Varied

Between 1984 and 1994 (the latest year for which data are available), FHA's share of all loans insured each year both for purchasing homes and refinancing existing mortgages has fluctuated between a low of 18 percent in 1984 and a high of 51 percent in 1987. PMIs' share during the same period fluctuated between a low of 29 percent in 1987 to a high of 69 percent in 1984. VA's share during this period stayed between 13 and 20 percent. The relative market shares of the mortgage insurers are shown in figure 1.2.

Figure 1.2: All Insured Mortgages, by Insurer, 1984-94



Source: GAO's analysis of HUD's data.

Between 1986 and 1990, FHA was the largest insurer. The factors contributing to FHA's large market share during these years may include an increase in FHA's maximum loan limit in 1988 and economic downturns in some areas of the country. Except for FHA's loan limit,[6] the terms, such as maximum LTV ratio, under which FHA and VA mortgage insurance is available do not generally vary across different geographic locations, according to program guidelines. However, PMI companies may change the conditions under which they will provide new insurance in a particular geographic area to reflect the increased risk of losses in an area experiencing economic hardship. By tightening up the terms of the

[6]FHA's loan limit may differ among geographic areas to reflect differentials in the cost of housing.

insurance they would provide, PMIs may have decreased their share of the market in economically stressed regions of the country.

From 1990 through 1992, the share of the market insured by FHA fell. This decrease may be a result, in part, of increased premiums for FHA insurance implemented as a result of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508). In 1992, the insurance premium for FHA mortgages decreased, which may have contributed to the rise in FHA's market share that took place in 1992 through 1994. Throughout the period from 1991 through 1994, the PMIs had a greater share of all insured single-family mortgage originations than FHA or VA. In 1994, the PMIs' share of all insured single-family mortgage originations was 48 percent, FHA's was 35 percent, and VA's was 17 percent.

Other Federal Homeownership Tools

The federal government uses a variety of tools to promote homeownership, in addition to providing mortgage insurance through FHA and VA. As mentioned above, the secondary market institutions (Ginnie Mae, Fannie Mae, and Freddie Mac) help make capital available for mortgage lending.[7] The Federal Home Loan Bank (FHLB) system also helps provide liquidity for lenders. The federal government insures deposits and provides advances to the thrifts and savings institutions that are members of the Federal Home Loan Bank system.

Federal tax incentives, such as the home mortgage interest deduction that is available to homeowners of all income levels, also are designed to encourage homeownership. Federal programs and requirements that are designed to make homeownership affordable, particularly among households who may be underserved by the private market, are discussed in chapter 4.

Objectives, Scope, and Methodology

To obtain more information about the role of FHA's single-family program in today's housing finance system, the Chairman of the Subcommittee on Housing and Community Opportunity, House Committee on Banking and Financial Services, asked us to provide information on (1) the terms of products available through FHA's Section 203(b) program in comparison with the terms of products available through the programs of the PMIs and VA; (2) FHA's share of the home purchase mortgage market, the characteristics of home buyers using FHA mortgage insurance in

[7]Fannie Mae and Freddie Mac are not federal agencies but are congressionally-chartered, shareholder-owned corporations.

comparison with other home buyers, and the portion of FHA borrowers who met certain qualifying ratios for private mortgage insurance; and (3) other federal programs and activities, besides FHA and VA, that promote affordable homeownership.

To compare the terms available through FHA's Section 203(b) program with the terms offered by PMIs and VA, we reviewed FHA's and VA's program regulations, FHA's mortgagee letters, and the underwriting guidelines and marketing materials published by the PMIs. Although the private mortgage insurance industry is composed of eight companies, we limited our review to the guidelines of the six companies that accounted for 97 percent of all new mortgages that were privately insured in 1994.[8] We also collected information on the insurance offered by PMIs through interviews with officials from four PMIs and from the Mortgage Insurance Companies of America (MICA). Because we wanted to compare the terms of private mortgage insurance that are most similar to the terms of FHA mortgage insurance, we focused on the affordable programs administered by the PMIs that may be used for loans with LTV ratios as high as 97 percent. We restricted our review of the terms of FHA single-family mortgage insurance to the Section 203(b) program because it is FHA's primary single-family mortgage insurance program.

We computed FHA's share of the home purchase mortgage market and compared the home buyers using FHA insurance to other home buyers by using the following data sources: (1) data reported through the HMDA on the volume of mortgages made by lenders in 1994 and the income, race, and location of borrowers; (2) data reported by MICA on the volume of mortgages insured by PMIs in 1994 and the income, race, and location of borrowers; (3) data from the 1993 American Housing Survey (AHS) conducted by the U.S. Department of Commerce on the age of home buyers; (4) data from HUD on the LTV ratio of the loans insured by FHA in 1994; (5) data from the Monthly Interest Rate Survey conducted by the Federal Housing Finance Board on the LTV ratios of conventional loans made in 1994; (6) data from VA on the LTV ratios of loans insured by VA in 1994; and (7) data from the Mortgage Bankers' Association (MBA) on first-time home buyers who took out mortgages in 1994. We used the data from the American Housing Survey, FHA, the Federal Housing Finance Board, VA, and the MBA because the HMDA and MICA data do not include data on the age of borrowers, LTV ratio, and first-time home buyers. We used 1993 and 1994 data because these were the most recent years for which

[8]The six companies we looked at are were Commonwealth Mortgage Assurance Company, GE Capital Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Company, Republic Mortgage Insurance Company, and United Guaranty Corporation.

data comparing FHA-insured loans with other types of loans were available. We did not attempt to examine trends over time in borrowers' characteristics because our objective was limited to describing how FHA's current clientele compares with other home buyers. We also limited our examination of borrowers' characteristics to home purchase mortgages, excluding mortgages taken out to refinance existing mortgages.

The data we used that were collected through HMDA do not include every mortgage made in 1994 for several reasons. First, not all lenders are required to report under HMDA. A depository institution is required to report if it has an office in a metropolitan area and its assets are at least $10 million. A mortgage company is required to report if it processes 100 or more mortgage applications. Second, the HMDA data we used do not include any mortgages made by lenders who do not lend in a Metropolitan Statistical Area (MSA). Third, the data do not include mortgages for non-owner-occupied homes. According to a Federal Reserve official, the HMDA data for 1994 include 77 percent of all home purchase mortgage loans.

Single-family mortgages insured through FHA's Section 203(b) program are not distinguished from mortgages insured through FHA's other smaller single-family mortgage insurance programs in the HMDA data. However, 60 percent of all single-family loans insured through FHA in 1995 were made through FHA's Section 203(b) program. Information on how FHA's 203(b) mortgages compare to mortgages insured through the other FHA programs is presented in chapter 4.

The data from MICA that we used pertain to nearly all of the mortgages insured by PMIs in 1994 through both standard and affordable programs. Although the MICA data pertain only to privately insured loans, the HMDA data consist of FHA-insured loans and all others. To compare FHA-insured mortgages to those insured by PMIs and to uninsured mortgages, in some cases we subtracted the number of loans reported to MICA from the non-government-insured loans in the HMDA data to obtain information about those loans that were uninsured. To take into account underreporting in the HMDA data, we reduced the MICA data by 23 percent when comparing the relative shares of the market for privately insured, FHA-insured, and uninsured loans.

We also used AHS data, which were derived from a 1993 survey of approximately 65,000 households. The data we used are from the subset of these households that acquired a mortgage in 1993. We also reviewed

existing studies conducted by officials at HUD, the Federal Reserve System, and the MBA.

We looked at borrowers' income, race, and first-time home buyer status because these characteristics have been highlighted by studies showing that certain types of borrowers, such as low-income borrowers, have difficulty obtaining mortgage credit. In addition, we looked at LTV ratios to compare the types of loans insured by FHA and by the PMIs, given differences in maximum allowable LTV ratios and the associated risk. We also looked at the state in which the loan was insured to identify geographic differences in the use of mortgage insurance. We could not compare the claim rates or loss rates of FHA-insured loans with other loans because data for privately insured and uninsured loans were unavailable.

We determined how many of the loans that FHA insured would have met PMIs' requirements through analysis of FHA home buyers' characteristics and PMIs' guidelines. Unlike the analyses described above for which 1994 and 1993 data were the most recent available, we were able to use 1995 data for this analysis because it only required information about FHA-insured mortgages. We asked FHA program staff to use their automated data to determine the percentage of 1995 FHA home buyers who reported on their loan application qualifying ratios and LTV ratios below the maximum levels generally allowed by PMIs (mortgages with LTV ratios no greater than 97 percent, total debt-to-income ratios no greater than 38 percent, and housing-expense-to-income ratios no greater than 33 percent).

We obtained most of our information on other ways in which the federal government helps to provide affordable homeownership opportunities by reviewing published information and by discussing program features with program officials at the various departments and agencies involved. We did not verify the accuracy or the completeness of the data provided by program officials. We also reviewed program regulations and budget submission information.

We provided a draft of this report to HUD, VA, Fannie Mae, Freddie Mac, and the MICA for their review and comment. We also provided excerpts from the draft report that pertained to their homeownership activities to the National Council of State Housing Agencies, the FHFB, the Neighborhood Reinvestment Corporation, and the U.S. Department of Agriculture's Rural Housing Service. All nine agencies provided comments. We incorporated these comments, as appropriate, throughout the report.

Some specific comments from HUD, MICA, and the FHFB are discussed at the end of chapters 3 and 4. Comments from MICA, the National Council of State Housing Agencies, the FHFB, and the Neighborhood Reinvestment Corporation are reproduced in appendixes III-VI.[9]

We performed our work from March 1995 through July 1996 in accordance with generally accepted government auditing standards.

[9]The other five agencies provided their comments orally.

Single-Family Mortgage Insurance Terms Offered by FHA, PMIs, and VA Are Different

The single-family mortgage insurance programs of FHA, PMIs, and VA protect private lenders against all or some of the losses that might result from foreclosure. However, the products offered by these organizations differ in terms of the (1) maximum mortgage amounts and LTV ratios allowed; (2) underwriting standards for borrowers, such as the income-to-expense qualifying ratio requirement; (3) funds required at loan closing for such items as down payment and closing costs; and (4) dollar amount or percent of loss that each organization will pay lenders to cover the losses associated with foreclosed loans.

While FHA's maximum loan amount, effective January 1, 1996, is $155,250, PMIs can insure and VA can guarantee loans that exceed this amount. On the other hand, PMIs can insure loans with a maximum LTV ratio of 97 percent, while both FHA and VA can insure/guarantee loans with ratios exceeding 100-percent. In addition, both FHA and VA generally require borrowers to pay less cash at loan closing than PMIs require. Finally, FHA provides lenders with essentially 100 percent protection against losses from foreclosed loans, while both PMIs and VA protect against a portion of the losses. While this chapter does not discuss all of the differences that exist in the terms offered by the three organizations, the terms described were cited as the most significant by industry and FHA officials we interviewed.

FHA offers a number of specialized insurance programs; however, because almost 60 percent of its home purchase loans in 1995 were made under the Section 203(b) program, our analysis of FHA addresses only this program.

Similarly, PMIs insure loans under a variety of different programs. In general, PMIs insure mortgages using what they refer to as either standard or affordable housing loans.[1] Affordable insurance programs differ from standard ones in that they offer more flexible underwriting guidelines than the PMIs' standard programs in several areas such as LTV ratios, qualifying ratios, and reserve requirements.[2] PMIs offer two types of affordable loans: (1) a maximum LTV ratio of 95 percent and (2) a maximum LTV ratio of 97 percent. The underwriting guidelines for the 97-percent LTV ratio are more restrictive than the 95-percent affordable program for things such as credit ratios. To compare the PMI programs that were most like FHA's Section 203(b) program and VA's loan guaranty program, we used the

[1]We focus on the six largest PMIs, which together insured about 97 percent of all loans receiving private mortgage insurance in calendar year 1994.

[2]Five of the six PMIs had different underwriting guidelines for their standard and affordable housing initiatives; the sixth had one set of guidelines that encompassed both types of products.

published underwriting guidelines for the PMI affordable loans and limited our review to the insurance terms for these loans.

While both FHA's and PMIs' programs can provide insurance to any borrowers who meet the programs' underwriting guidelines, VA's loan guaranty program is limited to qualified veterans and their survivors.

General Loan Requirements

When deciding whether to finance a home with a loan insured by FHA or a PMI, or guaranteed by VA, the prospective home buyer must consider both the amount of money needed to purchase the home and the amount of the down payment or other cash needs required by the lender. The three organizations differ in the maximum loan amounts and cash requirements for closing a loan.

Maximum Loan Amounts

While FHA is legislatively constrained by the dollar amount of loans it can insure, PMIs and VA are not. FHA's maximum loan amount for a single family home is legislatively set at the lesser of 95 percent of the median house price in the area or 75 percent of the conforming loan limit for Freddie Mac. As of January 1, 1996, FHA's maximum loan amount in the highest-cost areas was $155,250.[3] Many areas are not at the highest cost; these areas' maximum loan amounts range from $78,660 up to the high-cost limit.

While PMIs can insure loans of any size, they have established loan limits for loans insured under their affordable housing programs. This limit differs depending on the company. For loans with a 97 percent LTV ratio, four of the PMIs specified $203,150 as their maximum loan limit when this was the conforming loan limit; one stated that the limit was $250,000; and the remaining PMI did not specify a loan limit.

VA places no limit on the maximum loan that may be guaranteed, except that the mortgage may not exceed the home's appraised value plus the VA funding fee,[4] if it is financed. As a rule, however, lenders generally limit VA loans to four times the VA guaranty amount. Since the maximum VA

[3]In certain high-cost areas such as Hawaii and Alaska, the maximum FHA loan can be higher.

[4]For VA loans, a nonrefundable "funding fee," calculated as a percentage of the original loan amount, is charged to the borrower when a VA loan is originated.

guaranty is currently legislatively set at $50,750, VA loans will rarely exceed $203,000.[5]

Maximum LTV Ratios

FHA, PMIS, and VA differ in terms of their maximum allowable LTV ratios and how they calculate this ratio. FHA and VA allow higher LTV ratios than PMIS. The LTV ratio represents the ratio of the unpaid principal balance of the loan to the lesser of the appraised value or the sales price of the property. LTV ratios are important because of the direct relationship that exists between the amount of equity a borrower has in his/her home and the likelihood or risk of default.[6] The higher the LTV ratio, the less cash a borrower is required to pay out of his/her own funds. However, the higher the LTV ratio, the less cash the borrower will have invested in the home and the more likely it is that he/she may default on the mortgage obligations, especially during times of economic hardship. Thus, while FHA and VA's higher LTV ratios allow a home buyer to purchase a higher-priced home with less money, these loans have a greater risk of defaulting than PMI loans.

The Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508), enacted in November 1990, established LTV limits for FHA loans of 98.75 percent if the home value is $50,000 or less, or 97.75 percent if the home value is in excess of $50,000. However, because FHA allows financing of the up-front insurance premium, borrowers can in effect receive loans with LTV ratios that exceed 100 percent. The method of determining the maximum FHA mortgage amount requires two steps, as shown in table 2.1. The example assumes a home with a purchase price of $100,000 and closing costs of $2,300. We also assume that the purchase price is equal to or less than the appraised value of the property.

[5]The current conforming loan limit is $207,000.

[6]See Mortgage Financing: FHA Has Achieved Its Home Mortgage Capital Reserve Targets (GAO-RCED-96-50, Apr. 12, 1996).

Table 2.1: Calculation Example of FHA's Maximum Mortgage Amount

	Step 1: acquisition cost	Step 2: value
Purchase price[a]	$100,000	$100,000
Closing costs	2,300[b]	N/A[c]
Mortgage basis	$102,300	$100,000
Step 1[d]		
97 percent first $25,000	24,250	
95 percent the remainder	73,435	
Step 2 97.75 percent of value		97,750
Total	**$97,685**	**$97,750**
Mortgage allowed (lesser of 1 or 2)	$97,685	

[a]Calculations of maximum mortgage amount are based on the lesser of the appraised value or purchase price of the property.

[b]In this example, we assume that closing costs of $2,300 are financed in the mortgage. In effect, 95 percent of closing costs may be financed in the final mortgage.

[c]Not applicable.

[d]Calculating the maximum LTV ratio in this manner for loans over $50,000 insures compliance with the legislative LTV limits.

In the above example, the lesser of the two amounts, $97,685, becomes the maximum mortgage allowed. However, this is not the final mortgage amount if the borrower also finances the up-front, 2.25-percent insurance premium in the mortgage ($2,198 in the example above). The total mortgage in this case is $99,883 ($97,685 plus $2,198), or an LTV ratio of 99.9 percent of the purchase price.

PMIs, on the other hand, establish maximum LTV ratios for loans they insure, which means that any cost above this amount must be paid at closing. Essentially, all six of the PMIs allow LTV ratios up to a maximum of 97 percent. In general, loans having a maximum LTV of 97 percent fall under the PMIs' affordable housing loan programs.[7] The PMIs began to insure loans with a 97-percent LTV ratio in 1994. Loans with a 95-percent LTV ratio can be made under the affordable loan guidelines also, as well as under the companies' regular loan programs.

[7]Five of the six PMIs considered loans with a 97-percent LTV ratio as part of their affordable housing programs and have specific underwriting guidelines for these loans. The remaining PMI considered these loans as part of its standard program.

For VA loans, the maximum LTV ratio is 100 percent of the lesser of the amounts shown on the “certificate of reasonable value” issued by VA, or the “notification of value” issued by the lender if processed under VA’s Lender Appraisal Processing Program, or the selling price, plus the VA funding fee. The certificate or notification is issued in response to an appraisal request for the determination of reasonable value from a veteran, lender, builder, or owner. The certificate or notification is used to notify the requester of the maximum amount VA will guarantee.

Table 2.2 illustrates how each entity calculates its LTV ratio and summarizes the LTV calculations for each of the three entities. The example assumes a $100,000 purchase price (appraisal value) and a 30-year fixed-rate loan at 7.5 percent interest.

Table 2.2: LTV Calculations for FHA, VA, and PMIs

	FHA	VA	PMI (95 percent LTV)	PMI (97 percent LTV)
Purchase price	$100,000	$100,000	$100,000	$100,000
Plus allowable closing costs	2,300	–0-	–0-	–0-
Total	**$102,300**[a]	**$100,000**	**$100,000**	**$100,000**
Less down payment	$4,615[b]	–0-	$5,000	$3,000
Loan amount before up-front insurance premium	97,685[c]	$100,000	95,000	97,000
Plus up-front insurance premium/fee	2,198[d]	2,000	–0-	–0-
Total mortgage	**$99,883**	**$102,000**	**$95,000**	**$97,000**
Actual loan-to-value ratio, in percent	99.9	102.0	95	97

[a]FHA allows most closing costs to be financed.

[b]In this example, funds needed to close = acquisition cost less maximum mortgage amount: $102,300 - $97,685 = $4,615.

[c]See table 2.1 for calculation.

[d]Up-front insurance premium = $97,685 x 2.25% = $2,198.

As shown in table 2.2, the VA loan has an LTV ratio of 102 percent, the FHA loan has an LTV ratio of 99.9 percent, and the two PMI loans have LTV ratios of 95 percent and 97 percent—the lowest of the LTV ratios. These results reflect differences between the three organizations in their maximum allowable LTV ratios as well as their requirements for down payment and the financing of closing costs and insurance premiums.

Loan Underwriting Standards

When underwriting mortgage loans, FHA, PMIS, and VA all require that lenders examine a borrower's ability and willingness to repay the mortgage debt by examining the borrower's qualifying ratios and credit history. Differences exist in the qualifying ratios allowed among FHA, PMIS, and VA. However, differences in the written requirements for credit history examination among insurers were minimal.

Qualifying Ratios

Both FHA and PMIS use two qualifying ratios to determine whether a borrower will be able to meet the expenses involved in homeownership. The "housing-expense-to-income ratio" examines a borrower's expected monthly housing expenses as a percentage of his or her monthly income; and the "total-debt-to-income ratio" looks at a borrower's expected monthly housing expenses plus long-term debt as a percentage of his or her monthly income.

VA's underwriting standards are different in that they use the total-debt-to-income ratio in combination with an estimate of adequate monthly "residual income" when determining borrowers' qualifications for a home loan. VA defines residual income as gross monthly income less federal taxes and other monthly expenses. In qualifying a borrower, VA's underwriting guidelines establish a maximum total-debt-payment-to-income ratio and a minimum monthly residual income requirement. The monthly debt-payment-to-income ratio for VA borrowers is set at 41 percent. To qualify a borrower under VA's residual income method, housing (including mortgage payments) and other monthly payments are subtracted from the borrower's net take-home pay. Net take-home pay is gross income less federal income taxes. The remaining value is the residual monthly income for family support. VA provides a table of residual monthly incomes by region based on the Department of Labor's consumer expenditure surveys. VA provides the residual income tables as a guide to qualify borrowers; however, VA states that these figures should not automatically trigger approval or rejection of a loan.

Table 2.3 summarizes the housing-expense-to-income ratios and total debt-to-income ratios acceptable to the three organizations.

Table 2.3: Comparison of Qualifying Ratios for FHA, PMIs, and VA

Organizations	Housing-expense-to-income ratio	Total-debt-to-income ratio
FHA	29	41
PMIs[a]	28 or 33 for loans with a 97-percent LTV ratio	36 or 38 for loans with a 97-percent LTV ratio
VA	None	41

[a]Guidance for three of the PMIs stated qualifying ratios of 28 percent and 36 percent, while the other three stated ratios of 33 percent and 38 percent for fixed-rate, fixed-payment loans with a maximum LTV ratio of 97 percent. In addition, two of the PMIs stated that the total-debt-to-income ratio should not exceed 40 percent.

Each of the three organizations give examples of compensating factors, which may allow the borrower to exceed the maximum qualifying ratios or residual income figures in the case of VA. Examples of the compensating factors provided in the various underwriting guidelines include

- a large down payment;
- the demonstrated ability of the borrower to devote a greater portion of income to housing expense;
- substantial cash reserves;
- the borrower's net worth is substantial enough to evidence an ability to repay the mortgage regardless of income;
- evidence of an acceptable credit history or limited credit use;
- less-than-maximum mortgage terms;
- funds provided by a health, welfare, or community service organization for unusual services, house repairs, etc.; and
- a decrease in monthly housing expenses.

Credit Standards

In addition to the use of qualifying ratios to determine a borrower's ability to repay the mortgage debt, FHA, PMIS, and VA also require that a borrower's credit history be evaluated to determine his or her willingness to handle financial obligations in a timely manner. For these organizations, past credit performance serves as the most useful guide in determining a borrower's attitude toward credit. A borrower who has made payments on previous or current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments and delinquent accounts,

the organizations require that strong offsetting factors should exist for the loan to be approved.

The guidelines of FHA, PMIs, and VA are very similar in their approach and requirements for determining satisfactory credit. For all three, it is the overall pattern of credit behavior that must be examined rather than isolated occurrences of unsatisfactory or slow payments. A period of financial difficulty in the past does not necessarily make the risk unacceptable if a good payment record has been maintained since. For any derogatory items found, the PMI or lender must determine whether the late payments were due to a disregard for, or an inability to manage financial obligations, or to factors beyond the control of the borrower. All three organizations allow a good deal of judgment and interpretation on the part of the underwriter in determining the creditworthiness of the prospective borrower.

The use of information from national credit reporting agencies is required by all three organizations. However, they also allow lenders to use alternative methods of establishing credit histories for borrowers who do not have the type of credit history that would appear on a credit report. Other types of information that can be used include histories on the payment of utilities and rent.

Given the similarity between the three entities' credit standards and the fact that the standards are applied using judgment and interpretation, it was not possible, when comparing stated credit requirements, to determine which, if any, of these entities requirements are more, or less, stringent than the others. Such a determination would require a number of individual case studies to determine how specific borrowers would be judged when applying for a loan insured by a PMI versus FHA or VA.

Financing Loan Closing Costs

All three organizations require prospective home buyers to pay certain costs at the time of loan closing. Funds required to close a loan include down payment, closing costs, and premium/fee charges. In addition, five of the six PMIs require the home buyer to have cash reserves of 1 or 2 months' principal-interest-taxes-insurance after loan closing if it is a 97-percent LTV ratio loan. These differences are important because the amount of cash needed by the borrower at loan closing, to meet either closing costs or reserve requirements, represents a major barrier to homeownership for lower-income and first-time home buyers.

Table 2.4 shows the money a borrower will need at closing, including reserves, if needed, to purchase a $100,000 home assuming $2,300 in closing costs and a minimum down payment. As can be seen, VA requires the least amount of cash at closing ($2,300) while a PMI 95 percent LTV loan requires the most ($7,362).

Table 2.4: Total Cash Required at Closing on a $100,000 Home

	FHA	VA	PMI (95 percent LTV)	PMI (97 percent LTV)
Closing cost	$115[a]	$2,300	$2,300	$2,300
First month's mortgage insurance premium in advance	41	–0-	62	73
Down payment	4,500	–0-	5,000	3,000
Total cash to close[b]	**$4,656**	**$2,300**	**$7,362**	**$5,373**
Plus reserves needed in bank	–0-	–0-	–0-	$751
Total cash required	**$4,656**	**$2,300**	**$7,362**	**$6,124**

[a]Assumes the remainder is financed in the mortgage.

[b]In addition, the borrower will need cash to pay for taxes, insurance, and the required escrow balance. Since this amount varies widely from jurisdiction to jurisdiction and would be the same for each organization, we did not include an estimate in our example.

As stated earlier, the down payment needed for an FHA loan depends on the calculation of the maximum mortgage amount, which in our example discussed previously is $97,685. FHA allows the entire down payment to be a gift. In addition, up to 95 percent of the closing costs on an FHA loan can be financed through the mortgage.

Under their affordable programs, all of the PMIs require a minimum down payment of 3 percent from a borrower's own funds. Additional funds to be used for a larger down payment or for closing costs can come from a variety of sources, such as gifts or grants from family members, nonprofit organizations or public agencies; unsecured loans; or secured loans.

VA does not require a down payment, and all of the closing costs must be paid in cash at closing. However, the borrower can include the VA funding fee in the mortgage.

Premiums/Fees

FHA, PMIs, and VA all charge the borrower an insurance premium, or guaranty fee, to cover potential losses on mortgage loans that go into foreclosure. These organizations differ in the amount of premiums they charge to borrowers, the type of premium plans they offer, and whether or not these costs can be financed in the mortgage. FHA charges both a single, up-front premium as well as an annual premium for all mortgages over 15 years. The up-front premium is equal to 2.25 percent of the maximum mortgage allowed. It also can be financed as part of the mortgage and is partially refunded if the loan is paid in full during the first 7 years. The annual premium is equal to .5 percent of the outstanding mortgage balance and is charged for a time period that depends on the LTV ratio of the loan.[8] If the LTV calculation is less than 90 percent of the property's assessed value, the annual premium is charged for 11 years. If the LTV exceeds 90 percent, the premium is charged for a full 30 years or the full length of the loan, whichever is less. FHA's premium schedule was established by the Omnibus Budget Reconciliation Act of 1990.

PMIs charge different premiums to individual borrowers on the basis of the risk posed by that borrower. Premium rates will differ on the basis of factors such as the type of mortgage instrument that the borrower selects (i.e., fixed rate/adjustable rate), the purpose of the loan (i.e., home purchase/refinance), the LTV ratio, the length of the loan (30/25/15 years), and the amount of coverage that is required. PMIs also offer borrowers several different ways to pay premiums. However, PMI company representatives we interviewed stated that most borrowers choose to pay premiums under a monthly premium program because it allows them to pay less cash at closing. Under a monthly premium plan, only 1 month of the mortgage insurance premium is due at closing rather than for a year or more, as in other PMI plans. Since the PMI insurance premium is not paid up-front, there is no refund due if the insurance is canceled. On the other hand, FHA and VA borrowers pay an up-front premium. While the FHA mortgage insurance and VA loan guaranty remain in effect over the life of the mortgage, PMI mortgage insurance can be canceled if the unpaid principal balance of the mortgage has been paid down to either 80 percent of the original value of the property or 80 percent of the current appraised value of the property.

The amount of the funding fee charged by VA at loan origination depends on whether the veteran is a first-time or repeat borrower, the amount of the down payment, and whether or not the borrower is a reservist.

[8]For the purpose of determining how long the premium will be paid, the LTV is computed using the base loan amount excluding the up-front premium divided by the value of the property excluding closing costs.

Currently, for first-time use, the fee for loans with less than 5 percent down is 2 percent; with at least 5 percent down, 1.5 percent; and with at least 10 percent down, 1.25 percent. For eligible reservists, 0.75 percent is added to the above amounts. Repeat borrowers must pay a 3-percent fee for loans with less than 5 percent down. In addition, borrowers must pay the entire funding fee at loan closing. However, the fee can be financed as part of the mortgage.[9]

Reserves

Reserves represent the amount of monthly principal-interest-taxes-insurance that a borrower must have accumulated in savings at the time of loan closing. For loans with a 97-percent LTV ratio, the amount of reserves required by the PMIs differed, depending on the company. One PMI required 2 months reserves, four required 1 month, and one did not require any reserves. In addition, two of the PMI companies that required 1 month in reserves stated that these reserves could be waived under certain circumstances, such as if the property had a satisfactory mechanical and structural inspection and/or a homeowner's warranty. For loans with a 95-percent LTV ratio, PMIs generally do not require any reserves. FHA does not require a reserve, and VA's guidelines make no mention of them.

Insurance Coverage

FHA, PMIs, and VA differ in the amount of insurance or guaranty they provide to protect lenders against the losses associated with loans that go to foreclosure. Losses generally include the unpaid principal balance and delinquent interest due on the loan, legal expenses incurred during foreclosure, the expense of maintaining the home, and any advances the lender made to pay taxes or insurance.

While FHA essentially protects against almost 100 percent of the losses associated with a foreclosed loan, PMIs and VA protect only against a portion of the loss. For PMIs, the type and amount of coverage selected by the lender determine how much the private mortgage insurer will pay if the borrower defaults and the lender must foreclose. Typically, this amount is limited to between 20 percent and 30 percent of the losses but can go as high as 35 percent.

The amount that the VA guarantees against loss depends on the original loan amount, is set by law, and has been periodically increased by the

[9]Veterans receiving VA compensation for service-connected disabilities, or who, but for receipt of retirement pay, would be entitled to such compensation, and surviving spouses of veterans who died in service or from service-connected disabilities are exempt from the funding fee requirement.

Congress. Currently, the VA guaranty is as follows: (1) for loans up to $45,000, the VA will guarantee 50 percent of the loan; (2) for loans greater than $45,000, but not more than $56,250, the guaranty will not exceed $22,500; (3) for loans of more than $56,250 and not more than $144,000, the guaranty will be the lesser of 40 percent of the loan or $36,000; and (4) for loans of more than $144,000, the guaranty is the lesser of 25 percent of the loan or $50,750.

Table 2.5 illustrates the amount that FHA, PMIS, and VA would have to pay for a loan that is foreclosed on at the end of the fourth year of a mortgage. As shown in the table, FHA suffers a loss of $44,500 on the foreclosed loan as opposed to $36,000 for VA and $30,449 to $31,068 for PMIS. The differences in losses are primarily related to the limits on insurance or guaranty coverage provided by each organization. Those losses not incurred by the mortgage insurers become the responsibility of the lenders.

Table 2.5: Comparison of Foreclosure Losses for Lenders and Insurers

	FHA	VA	PMI (95 percent LTV)	PMI (97 percent LTV)
Home purchase price	$100,000	$100,000	$100,000	$100,000
Original loan amount	$99,883	$102,000	$95,000	$97,000
Percent of insurance coverage	100	35	30	30
Loan foreclosed at end of 4th year				
Outstanding loan amount	$95,749	$97,778	$91,068	$92,985
Delinquent interest (12 months)	7,181	7,333	6,830	6,974
Legal and filing fees	2,500	2,500	2,500	2,500
Property taxes	600	600	600	600
Hazard insurance	300	300	300	300
Preservation cost[a]	200	200	200	200
Total cost	**$106,530**	**$108,711**	**$101,498**	**$103,559**
Revenues from sale of property	$60,000	$60,000	$60,000	$60,000
Total loss paid/incurred by insurer	**$44,500**[b]	**$36,000**[c]	**$30,449**[d]	**$31,068**[d]
Net loss to lender/mortgage holder	$2,030	$12,711	$11,049	$12,491

Note: For this analysis, we assume that the process of acquiring, maintaining, and disposing of properties is equally efficient among FHA, VA and PMIs.

[a]This covers the expenses of maintaining the property until it is resold.

[b]Loss includes everything except what FHA does not allow—one-third of the administrative costs ($833) and 2 months of delinquent interest ($1,197).

[c]The actual claim amount that VA pays when a loan is terminated depends on the total costs to acquire the property minus the amount that VA determines to be the net value of the property at the time of foreclosure. VA computes net value by subtracting a fixed percent (currently 15.11 percent) from the fair market (appraised) value. In this example, we assume that the net value is $60,000, and therefore VA pays the maximum claim amount—$36,000.

[d]For both PMI examples, the loss is calculated by multiplying the total cost by 30 percent.

FHA's additional losses of about $9,000 to $14,000 reflect the additional risk exposure that FHA assumes from insuring the lender for close to 100 percent of the loss.

Observations

PMIs have recently begun to offer a number of specialized or affordable housing programs with more flexible underwriting guidelines and higher LTV ratios than their standard mortgage insurance programs. However, the terms offered by FHA and VA still differ in important ways from those offered by PMIs. These differences affect the size of mortgage loans that borrowers can obtain, the amount of cash needed by borrowers at loan closing, and the exposure to risks assumed by these organizations.

PMIs can insure and VA can guarantee mortgage loans that exceed those that can be insured by FHA. More importantly, however, FHA's and VA's underwriting standards reduce the amount of cash needed to purchase a home to a greater extent than the PMIs' new affordable standards. While the additional funds needed to purchase a PMI-insured home would not eliminate the borrower's ability to purchase a home at some point in time, it can delay the purchase date substantially or require the borrower to purchase a less costly home. Primarily because PMIs and VA both limit their losses to a portion of the loss and FHA does not, losses on FHA-insured homes that enter foreclosure are greater than the losses experienced by VA and PMI on similar homes, all other things being equal. The additional loss for FHA reflects the additional risk exposure that it assumes from insuring the lender for close to 100 percent of the loss. It should be stressed, however, that under FHA's Section 203(b) program, FHA borrowers' premiums pay for these losses, not the U.S. Treasury.

FHA Has a Major Role in the Housing Market

FHA is a major participant in the housing market. It insured nearly 15 percent of all reported home purchase loans made in 1994 and 35 percent of the insured loans and fulfills a larger role in some specific market segments, particularly low-income, first-time home buyers and minorities. On the basis of the loan-to-value and qualifying ratios of the FHA loans made in 1995, most of the FHA-insured loans would probably not have been made by private mortgage insurance companies. However, the largest number of home purchase loans made during 1994, including the loans to low-income and minority borrowers, were not insured. More than twice as many uninsured loans were made to low-income and minority borrowers as were made by FHA.

This chapter compares the statistics for FHA, the PMIS, VA, and uninsured mortgages in the housing market. It provides information on FHA's share of loans made to low-income, first-time home buyers and minority borrowers, as reported in the Home Mortgage Disclosure Act (HMDA) data. To the extent that data are available, a comparison of the characteristics of insured borrowers (FHA, PMIS, and VA) to uninsured borrowers in the housing market is also presented. Besides income, race, and first-time home buyers, the characteristics discussed include the borrowers' age, the location of the home, and the LTV ratio of the loan. This discussion covers all single-family home purchase loans originated in 1994.

FHA Insured a Large Number of All Home Purchase Loans Made in 1994

FHA insured 14.7 percent (519,102) of all home purchase loans made in 1994 and included in the HMDA data.[1] HMDA recorded 6.1 million loans made in 1994, including about 4.1 million loans that were not insured. A large portion of the 6.1 million loans made were refinanced loans (42 percent, or 2.5 million) and are not included in the analysis in this chapter because we wanted to focus on the characteristics of home purchase mortgage borrowers.

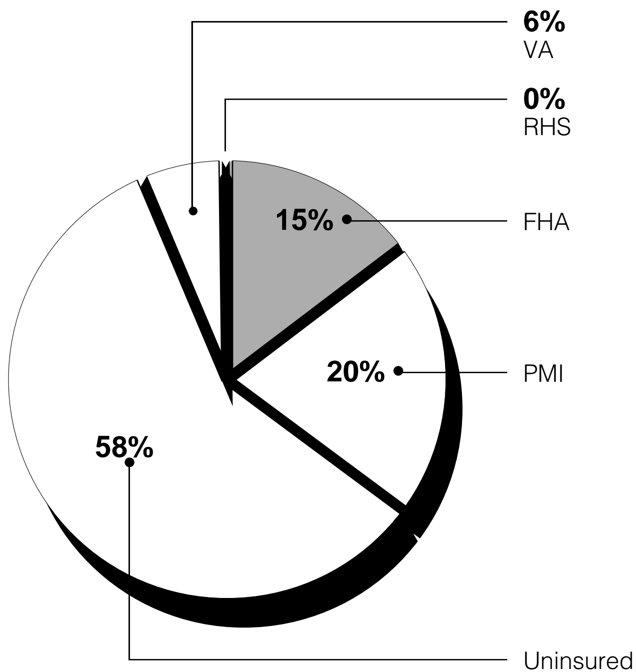
Figure 3.1 shows the type of insurance obtained on the 3.5 million home purchase loans included in the HMDA data. We estimate that the PMIS insured 20.5 percent, or 725,188,[2] of these loans made in 1994. VA guaranteed another 6.2 percent of the mortgage market. Rural Housing Service (RHS) guaranteed less than 1 percent of home loans in 1994. The

[1]As stated in chapter 1, the HMDA data cover less than the total number of home mortgages because some institutions are not required to report and some institutions underreport loans made.

[2]We reduced the MICA data on all home purchase loans made by PMIs by 23 percent to reflect a reasonable estimate of the extent to which the HMDA data are incomplete. In doing this, we are implicitly assuming that the share of conventional loans insured by PMIs is the same for loans included in the HMDA data as it is for those not included in those data.

largest share of the home purchase loans, which we estimate to be about 58.5 percent or 2.1 million, was uninsured. (Table I.3 in app. I lists total home purchase loans reported by HMDA, by type of insurance.)

Figure 3.1: Market Share of Home Purchase Loans Made in 1994



Source: GAO's analysis of data from HMDA and MICA.

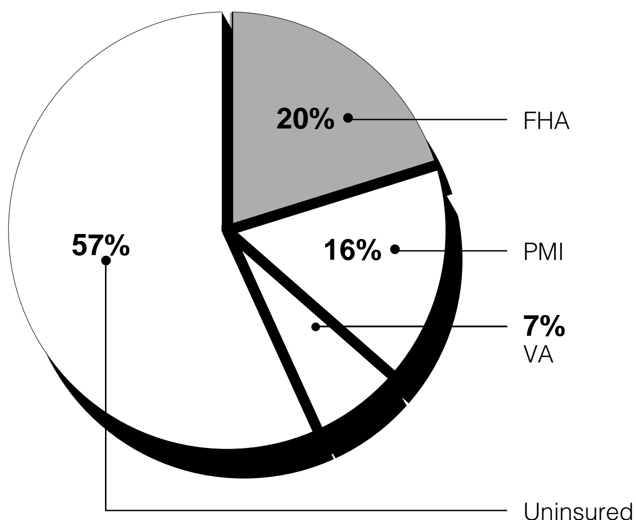
FHA Insured One-Fifth of All Home Purchase Loans Made to Low-Income Borrowers in 1994

We estimate that FHA insured about one-fifth of the approximately 1.1 million home purchase loans[3] in the 1994 HMDA data made to low-income borrowers.[4] We estimate that FHA insured more of these loans (20.1 percent) than the PMIs (16.2 percent) or VA (6.7 percent), as shown in figure 3.2. FHA's share of home purchase loans made to low-income borrowers was higher than its 14.7 percent share of the housing market. However, more than half of the home purchase low-income borrowers were uninsured; the percentage of uninsured home purchase loans made to low-income borrowers is about the same as for all borrowers. (A break down of all loans made in 1994 by income classification is contained in table I.4 of app. I.)

[3]We were able to use only about three quarters of the HMDA data in assigning income categories, primarily because of missing information on location and income. We applied the percentage we found for these data to the total number of loans in the HMDA data, as well as to our estimates of loans in each insurance category (FHA, VA, PMI, and uninsured). In doing this, we are implicitly assuming that the loans for which we do not have the data needed to assign an income category would be divided in the same way among income categories and, for the conventional loans, between PMIs and uninsured, as the loans for which we can assign income categories.

[4]Low-income borrowers are defined as borrowers whose income is less than or equal to 80 percent of the Metropolitan Statistical Area's median family income.

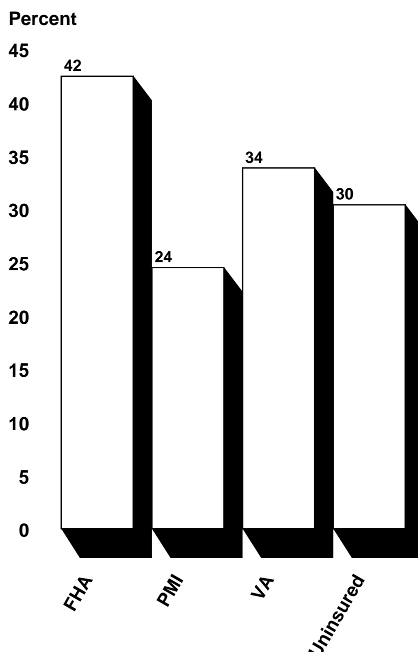
Figure 3.2: Market Share of Home Purchase Loans Made to Low-Income Borrowers in 1994



Source: GAO's analysis of data from HMDA and MICA.

Figure 3.3 shows the proportion of each insurer's 1994 home purchase loans that were made to low-income borrowers. Forty-two percent of the home purchase loans that FHA made were to low-income borrowers. For PMIs, a smaller percentage (24.5 percent) of the home purchase loans they insured were for low-income borrowers. Thirty-four percent of VA home purchase loans and 30 percent of the uninsured home purchase loans were made to low-income borrowers.

Figure 3.3: Proportion of Home Purchase Loans Made to Low-Income Borrowers in 1994



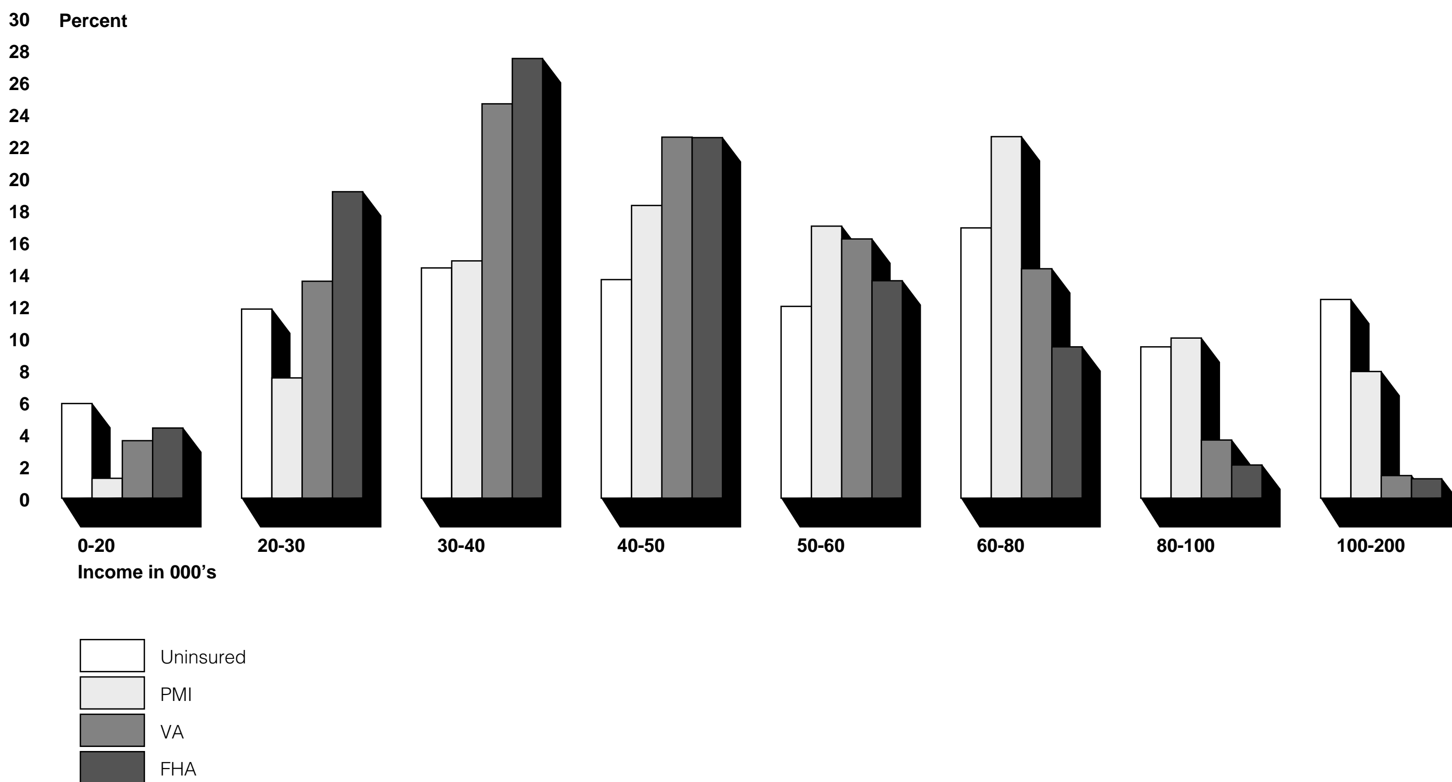
Source: GAO's analysis of data from HMDA and MICA.

As discussed previously, FHA generally does not insure loans over the FHA loan limit (maximum amounts were $151,725 for most of 1994 and $155,250 in 1996 for the areas with the highest housing costs), while PMIS and VA can insure higher-value loans. Consequently, it is useful to know how the PMIS would compare with FHA when facing similar constraints. When comparing the home purchase loans that the PMIS made under the FHA loan limit, the share of the PMIS' business that is composed of low-income borrowers increases. According to data obtained from the Federal Reserve Board,[5] in 1994, 33 percent of the PMI home purchase loans that were less than the FHA loan limit were to low-income borrowers. These data also indicate that 45 percent of FHA's business in 1994 was to low-income borrowers, similar to the 42 percent we found in the HMDA data.

[5]Glenn Canner and Wayne Passmore, "Credit Risk and the Provision of Mortgages to Lower-Income and Minority Home Buyers", The Federal Reserve Bulletin, Vol. 81, No. 11, November 1995.

Figure 3.4 shows the percent of each insurer's home purchase loans made at various borrowers' income ranges. As shown, FHA and VA loans are more concentrated in the lower income ranges compared with PMI and uninsured loans. The Mortgage Bankers Association[6] also reports that the average income of FHA borrowers for calendar year 1993 was lower than the average income of the PMIs' borrowers. (Table I.5 in app. I lists the percentage of each group's loans that fall within the listed income ranges.)

Figure 3.4: Proportion of Home Purchase Loans, by Income Group, in 1994



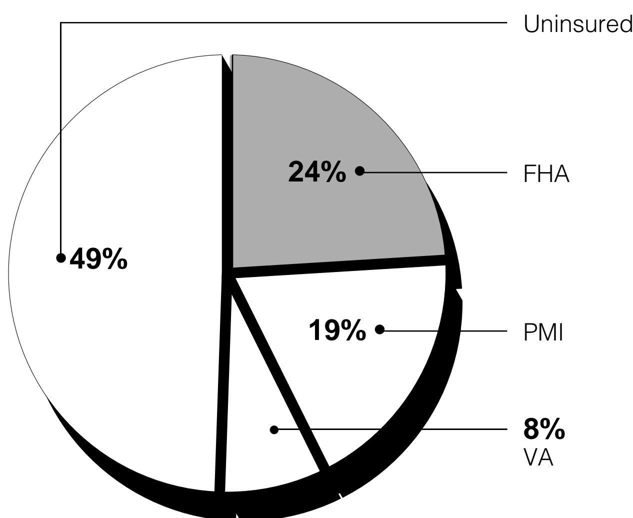
Source: GAO's analysis of data from HMDA and MICA.

[6]FHA Single-Family Insurance Program: A Primer, MBA, Washington, D.C., 1995. This primer gives many statistics, historical and current, on FHA loan characteristics and compares FHA's and PMIs' insured loans.

FHA Insured Nearly One-Fourth of All Loans Made to Minorities in 1994

According to GAO's estimate of the HMDA data, about 613,550[7] home purchase loans were made to minorities in 1994.[8] FHA insured more loans for minority borrowers in 1994 than the PMIs and substantially more than VA. FHA insured about 147,423 minority loans in 1994 compared with about 114,197 insured by PMIs. Figure 3.5 shows the relative share of the insured and uninsured minority market.

Figure 3.5: Market Share of Home Purchase Loans Made to Minorities in 1994



Source: GAO's analysis of data from HMDA and MICA.

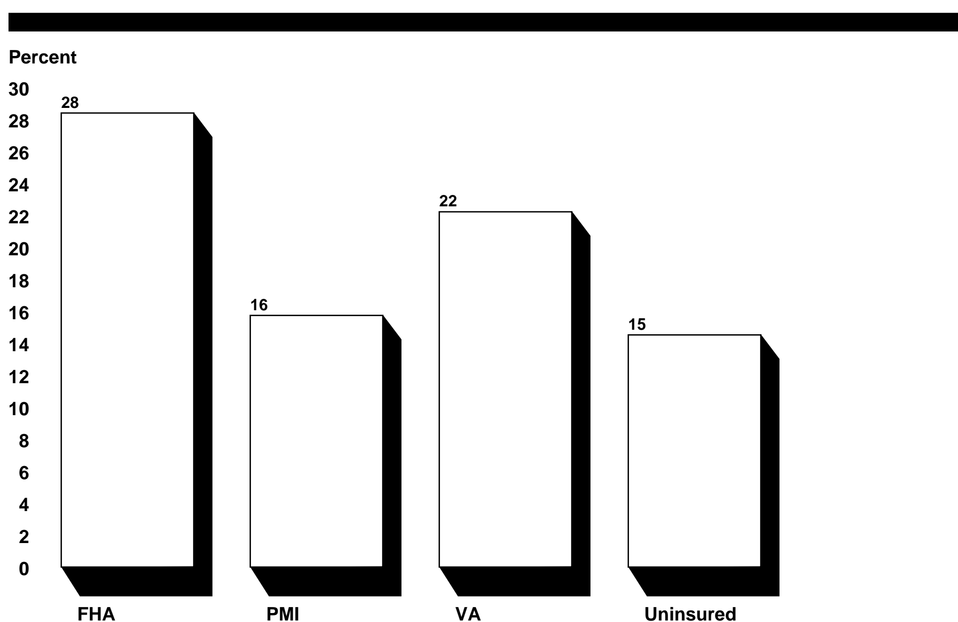
Although the majority (2.9 million, or 83 percent) of all home purchase loans made in 1994 were to white borrowers, FHA's 1994 loans consisted of a larger share of minority loans than any other insurer. As shown in figure 3.6, 28 percent of FHA loans were to minorities. For the PMIs, 16 percent of

[7]As with low-income borrowers, the HMDA data were adjusted for unequal reporting of FHA, VA, and conventional loans. The HMDA data were also adjusted to take into account that a higher percentage of PMI loans did not indicate race. We made the assumption that the relative percent of PMI to uninsured loans remained the same in the nonreporting population as in the reporting population.

[8]"Minorities" include African Americans, Asians, Hispanics, and American Indians.

their loans were to minorities,[9] while of the VA loans made in 1994, 22 percent were to minorities. Even though only 15 percent (303,477) of 2.1 million uninsured loans were made to minority borrowers, 49 percent of all minority loans made were uninsured. (Table I.6 in app. I lists the number of minority and nonminority home purchase loans made, by insurance type.)

Figure 3.6: Proportion of Home Purchase Loans Made to Minorities in 1994



Source: GAO's analysis of data from HMDA and MICA.

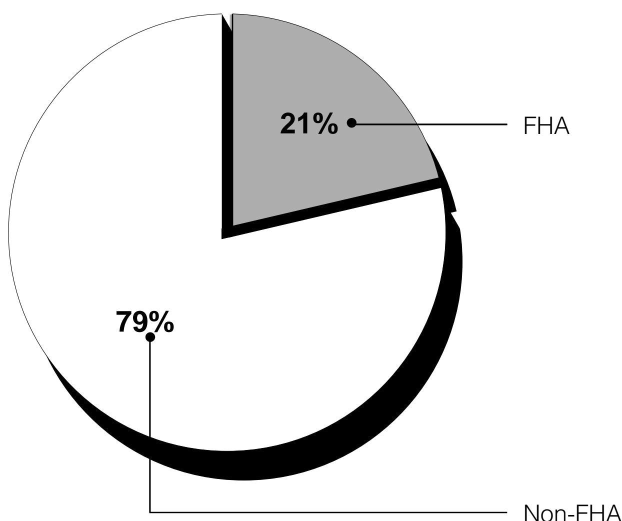
In addition, the Federal Reserve reported that in 1994, home purchase loans below the FHA loan limit made by PMIs were about 21 percent minority, while FHA home purchase loans were about 26 percent minority. When considering loans made under the FHA loan limit, FHA is still more concentrated with minority borrowers than the PMIs.

[9]Of the 941,566 PMI loans reported by the Mortgage Insurance Corporation of America (MICA), 20 percent (190,635) were classified as "other" in the data. In addition to when "other" was indicated on the application, the term "other" was coded when the information was not provided by the applicant in a mail or telephone application. These data were removed before the calculation of the minority percentage. The actual distribution of these loans can affect the ratios presented for PMIs.

FHA Insured More Than One-Fifth of All First-Time Home Buyers in 1994

FHA insured a higher percentage of loans for first-time home buyers than its share of the market in 1994. However, non-FHA-loan providers made about four times as many loans (79 percent) as FHA (21 percent) to first-time home buyers in 1994. According to the Mortgage Bankers Association (MBA), in 1994, about 4.6 million home purchase mortgage loans were made in the home mortgage market.[10] Of these loans, FHA insured 15 percent (686,487). Furthermore, MBA reported that about 2.2 million loans were made to first-time home buyers in 1994; FHA insured 21 percent of these loans (see fig. 3.7). The MBA report does not distinguish between private insured and uninsured mortgages. These are combined with VA loans and make up the Non-FHA group shown in figure 3.7. (Table I.7 in app. I lists the number of first-time home buyers for FHA and non-FHA home purchase mortgages.)

Figure 3.7: Market Share of Home Purchase Loans Made to First-Time Home Buyers in 1994



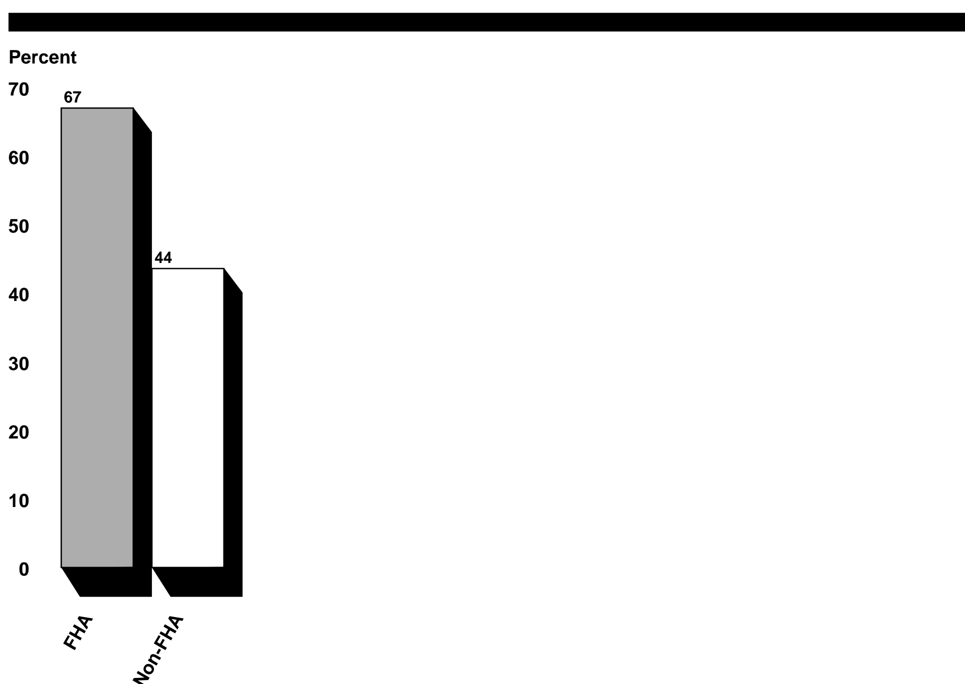
Note: Non-FHA includes PMIs, uninsured mortgages, VA, and the RHS.

Source: GAO's analysis of Mortgage Bankers Association's data.

[10] FHA Single-Family Insurance Program: A Primer, p. 21. The number of mortgage loans made as reported by MBA is different than the number discussed elsewhere in this chapter because the data reported to HMDA are only about 77 percent of all home purchase mortgages issued. Also, sources of information are different.

Compared with others in the home mortgage market, on average, FHA made a higher proportion of loans to first-time home buyers. MBA's data show that about 67 percent of all 1994 FHA home purchase borrowers were first-time home buyers and 44 percent of non-FHA home purchase borrowers were first-time home buyers. Figure 3.8 shows the share of FHA and non-FHA loans made to first-time home buyers.

Figure 3.8: Proportion of Home Purchase Loans Made to First-Time Home Buyers in 1994



Source: GAO's analysis of MBA's data.

In addition to the study by MBA, HUD's Policy Development and Research Division also analyzed the characteristics of loans. The HUD study reported that for the period 1989-91,[11] 66 percent of FHA home purchase borrowers were first-time home buyers, while 56 percent of PMIs' home purchase borrowers were first-time home buyers. They also report that 87 percent of FHA's first-time home buyers are 40 years old or younger.

[11] An Analysis of FHA's Single-Family Insurance Program, HUD's Office of Policy Development and Research, Oct. 1995.

FHA Borrowers Are Younger Than Conventional Borrowers

According to GAO's analysis of the 1993 American Housing Survey, FHA insured 9 percent of home purchase mortgages received in 1993 prior to the survey.[12] This is lower than its 14.7 percent share of the home purchase mortgage market in 1994 in the HMDA database. The age distribution of borrowers, as indicated in the 1993 AHS data, shows that FHA borrowers tend to be younger than other borrowers. Sixty-two percent of FHA home purchase borrowers are less than 40 years old, while only 38 percent of the conventional home purchase loans were obtained by borrowers under 40. According to GAO's analysis of the AHS data, of the 2.9 million home purchase loans made in 1993 prior to the survey, 41 percent were made to people under the age of 40 and 14 percent of them were insured by FHA. This is a larger share of this market segment than FHA's share of the entire market for 1993. Conventional loans (private insurers and uninsured groups combined) had 82 percent of the younger-than-40 submarket, and VA provided the remaining 4 percent. (Table I.8 in app. I lists, by borrowers' age, the number of FHA, VA, and conventional loans made prior to the 1993 AHS.)

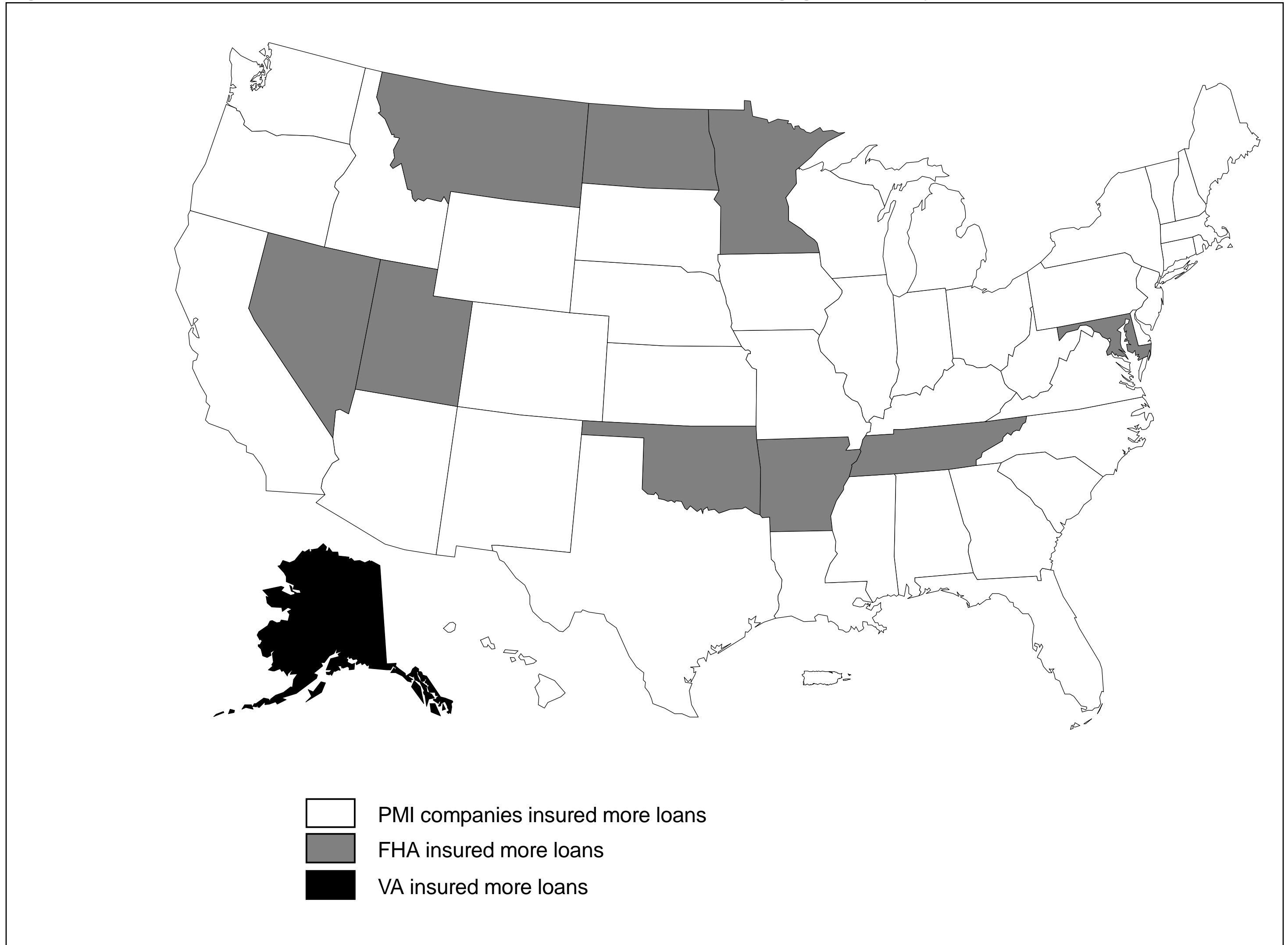
FHA Was the Primary Insurer in at Least Nine States

FHA's relative share of the insurance market varied from state to state. According to the HMDA data for 1994, although PMIS insured more home purchase loans than FHA, FHA made more home purchase loans than the six PMIS combined in at least nine states[13]—Arkansas, Maryland, Minnesota, Montana, Nevada, North Dakota, Oklahoma, Tennessee, and Utah. In all except 4 of the 50 states, FHA's share is between 20 and 50 percent. In Iowa, Massachusetts, and Wisconsin, FHA's business was less than 20 percent of the market. VA's share of the insured market was the highest only in the state of Alaska. Figure 3.9 shows which of the three insurers—FHA, PMIS, or VA—made the greatest number of home purchase loans in each state during 1994. (Table I.9 in app. I lists FHA's relative share of the insurance market in each state.)

[12]The AHS' 1993 national survey of housing (conducted between July and December 1993) covers a sample of 64,998 homes throughout the country. When the sample is weighted, the AHS shows that there were 2.903 million home purchase mortgages obtained in 1993 prior to the survey. Of this universe, FHA's share is 9.36 percent and has a sampling error of 1.6. In other words, using the AHS data, FHA's share of home purchase mortgages reported by AHS with 95 percent likelihood is between 10.96 and 7.76 percent.

[13]Within the MICA data, 204,516 of all PMI loans and 72,319 FHA loans within the HMDA data did not have a state code or contained edit failures. When the adjustments were made for under count in the HMDA data and to account for missing state codes and edit failures, we estimated that an additional four states may have been primarily insured by FHA (Arizona, Colorado, Mississippi, and South Dakota). Two other states (Louisiana and Virginia) are estimated to have the same percentage of home purchase loans insured by PMI companies and FHA.

Figure 3.9: Each Insurer's Relative Share of the Insured Home Purchase Mortgage Market, by State, in 1994

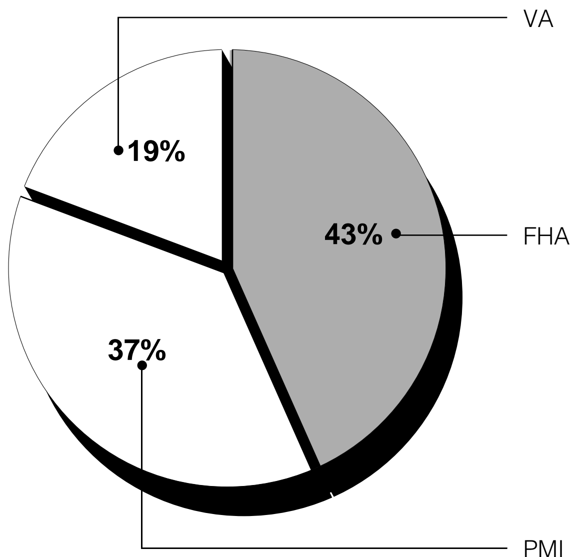


Source: GAO's analysis of data from HMDA and MICA.

FHA Insured Nearly Half of All Loans With a Loan-To-Value Ratio Greater Than 90 Percent

Of all home purchase loans made in 1994 with an LTV ratio of at least 90 percent, FHA insured 43 percent of them. The PMIs insured 37 percent and VA guaranteed 19 percent.[14] This occurred even though the PMIs made 49 percent of the insured home purchase loans in 1994, FHA made about 35 percent, and VA made only 15 percent. Generally, a borrower is required to have mortgage insurance if the LTV ratio is above 80 percent. The LTV ratios of uninsured loans are generally below 80 percent. Figure 3.10 compares FHA, PMI, and VA in the high LTV ratio market.

Figure 3.10: Market Share of Home Purchase Loans Made With a Loan-To-Value Ratio of at Least 90 Percent in 1994



Notes: The VA loans used in this graph are those loans with an LTV ratio greater than 91 percent, as VA's data are accumulated in this manner. We assumed that conventional loans with LTV ratios below 80 percent are uninsured.

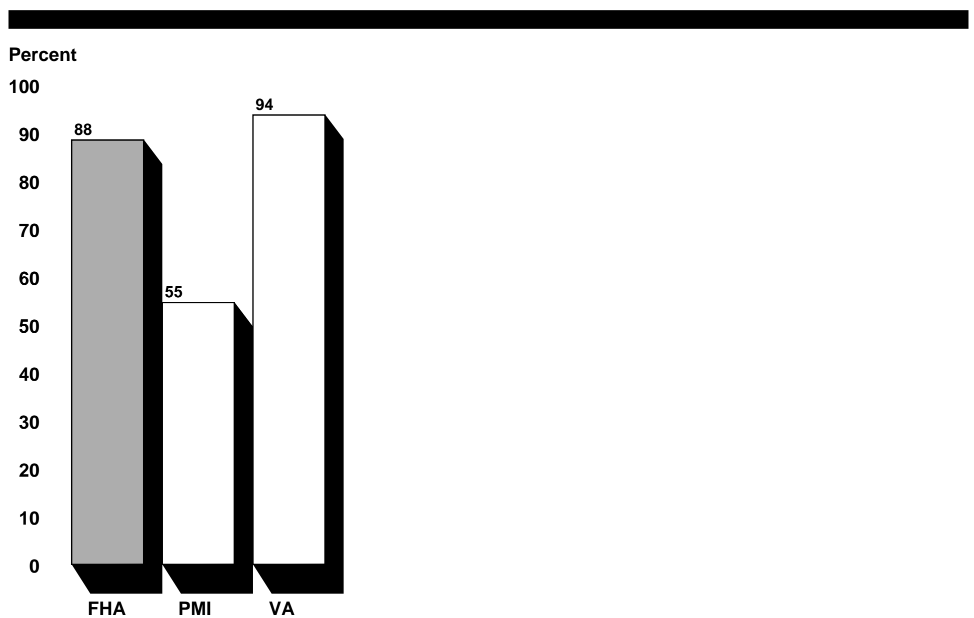
Source: GAO's analysis of data from FHA, Federal Housing Finance Board, VA, HMDA, and MICA.

In addition to the number of loans made with high LTV ratios, there was also a difference between the proportion of such loans made by FHA and

[14]Loan to value is defined as the loan amount divided by the property's appraised value. FHA adjusts the LTV calculation by (1) reducing the loan amount by the amount of the mortgage insurance premium that is financed and (2) including closing costs with the appraised value.

PMIs. This difference is demonstrated by figure 3.11, which shows that 88 percent of FHA's loans had LTV ratios of at least 90 percent, compared with 55 percent of the PMI loans with such LTV ratios. In addition, up to 94 percent of VA loans guaranteed in 1994 had an LTV ratio greater than 91 percent.

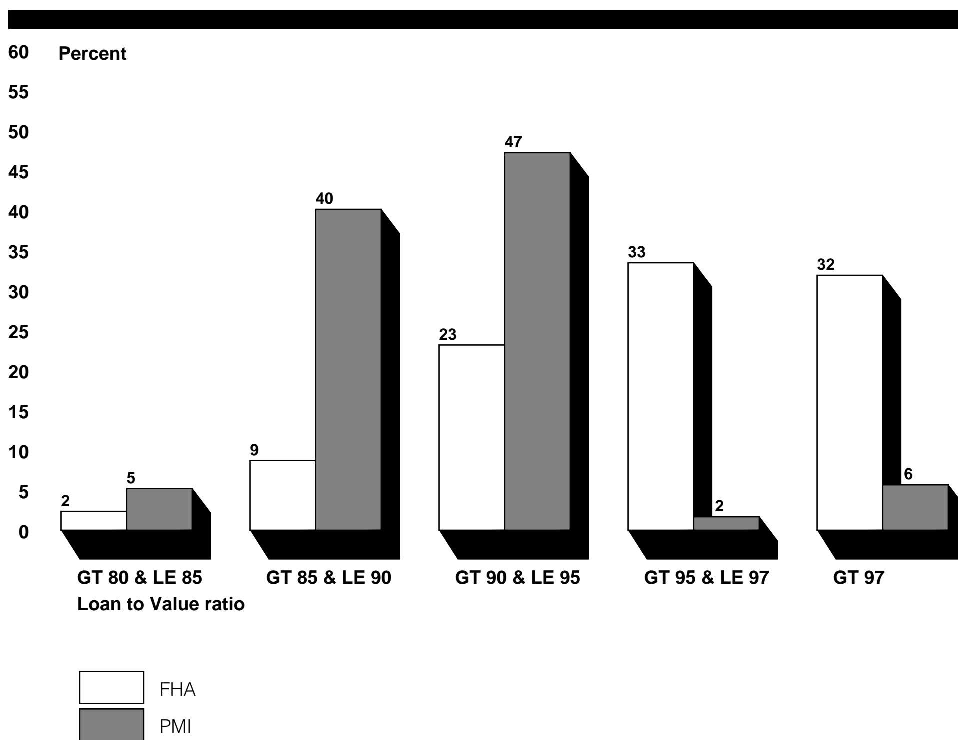
Figure 3.11: Proportion of Home Purchase Loans Made With a Loan-To-Value Ratio of at Least 90 Percent in 1994



Source: GAO's analysis of FHA's, VA's, and the Federal Housing Finance Board's data.

Furthermore, as shown in figure 3.12, 65 percent of FHA-insured loans had LTV ratios of 95 percent or greater, while only about 8 percent of PMI loans had LTV ratios greater than 95 percent. VA, shown separately in figure 3.13, has the vast majority of its guaranteed loans concentrated in the greater than 97 percent LTV range. (Tables I.10 and I.11 in app. I list the percentage of FHA, VA, and PMI home purchase loans within selected income ranges.)

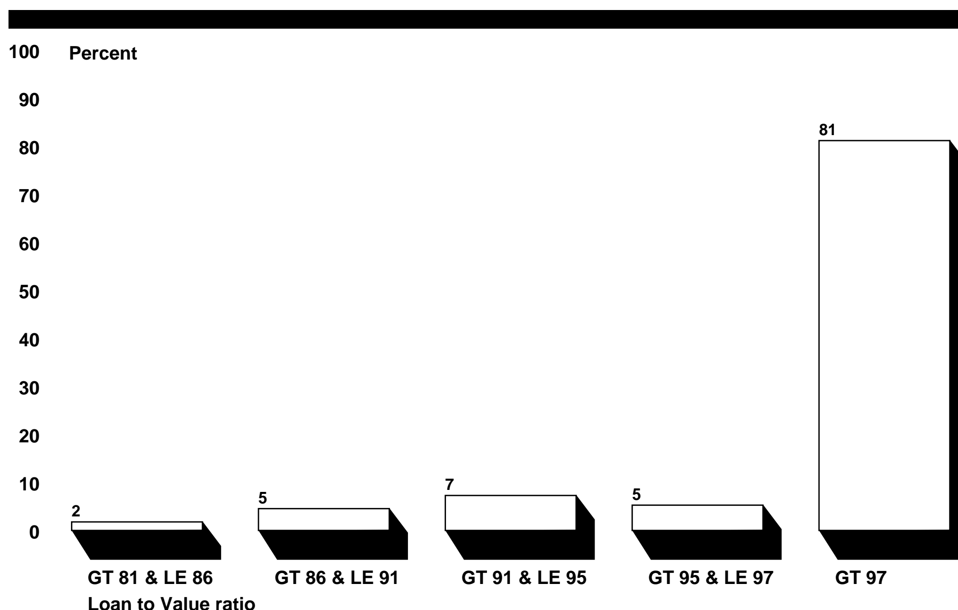
Figure 3.12: Proportion of FHA and PMI Home Purchase Loans, by Loan-To-Value Ratio, in 1994



Note: GT means greater than, and LE is less than or equal to.

Source: GAO's analysis of FHA's and the Federal Housing Finance Board's data.

Figure 3.13: Proportion of VA Home Purchase Loans, by Loan-To-Value Ratio, in 1994



Note: GT means greater than, and LE is less than or equal to.

Source: GAO's analysis of VA's data.

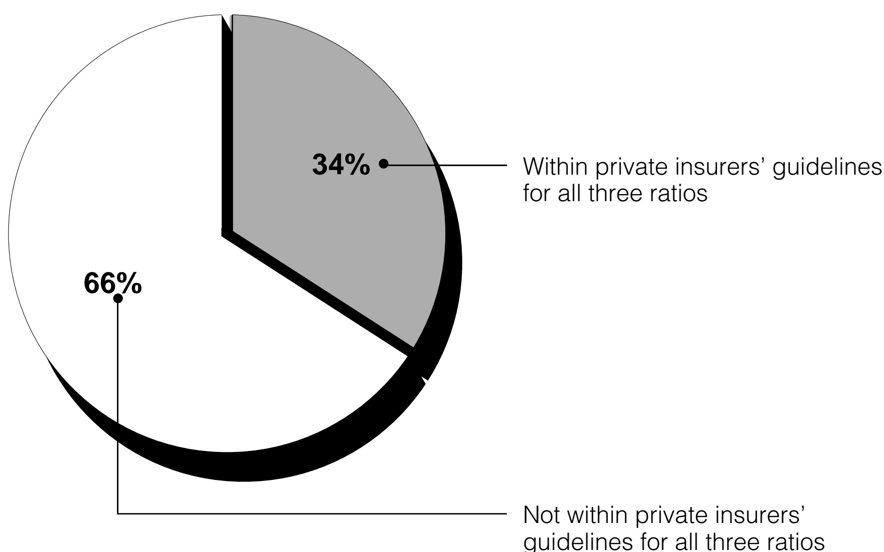
Most FHA-Insured Home Purchase Loans Would Not Have Been Insured by Private Mortgage Insurers

While some FHA-insured home purchase loans might qualify for private mortgage insurance, most might not have been written under the same terms by private mortgage insurers. Specifically, on the basis of the PMIs' most liberal standards for (1) maximum LTV, (2) housing-expense-to-income, and (3) total-debt-to-income ratios alone, about two-thirds of FHA's 1995 home purchase borrowers would not qualify for private mortgage insurance on the loans they received. That is, these borrowers had loans with LTV ratios greater than 97 percent, had housing-expense-to-income ratios greater than 33 percent, or had total-debt-to-income ratios greater than 38 percent.

Conversely, about one-third of FHA's single-family home purchase borrowers met the most liberal private mortgage insurance guidelines for LTV and total-debt-to-income ratios. These borrowers had loans with LTV ratios of 97 percent or lower, had ratios of housing-expense-to-income of 33 percent or lower, and had total-debt-to-income ratios of 38 percent or lower. This potential overlap in FHA-insured borrowers that may qualify for

private mortgage insurance is shown as the shaded area in figure 3.14. In addition, relatively fewer FHA first-time home buyers and borrowers with low incomes met all three of these ratios. That is, while 34.1 percent of all home purchase FHA borrowers met all three ratios, only 22.6 percent of FHA's first-time home buyers and 14.5 percent of FHA's low-income home purchase borrowers met all three ratios.

Figure 3.14: Proportion of FHA Home Purchase Loans Made in 1995 That Meet Private Insurers' Guidelines for All Three Ratios



Source: GAO's analysis of FHA's data.

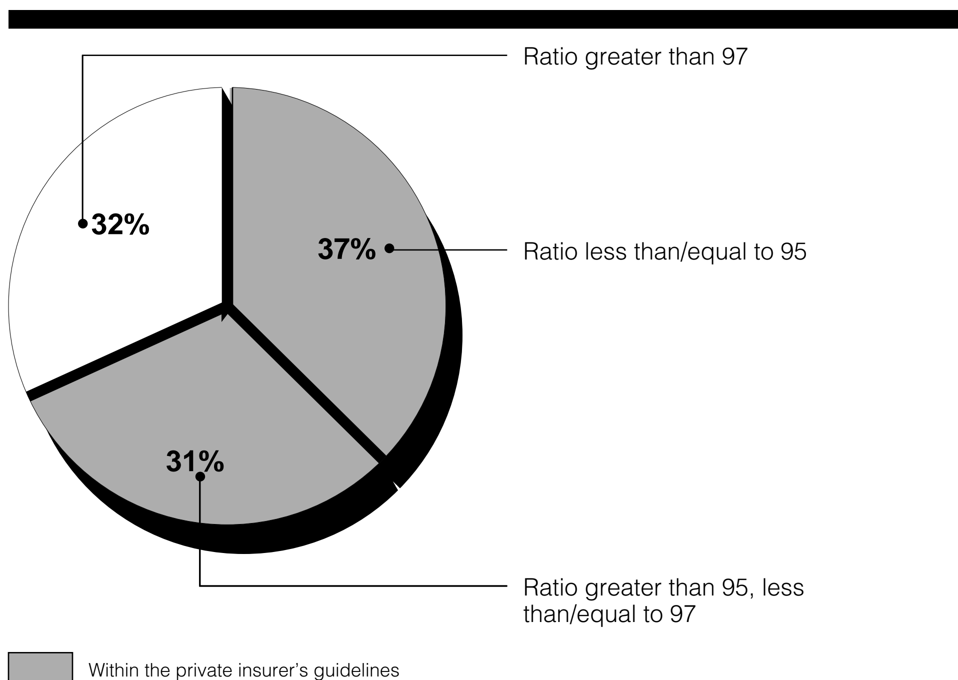
We cannot say with certainty that if an FHA borrower meets all three of the PMIs' guidelines, a PMI would insure that borrower's mortgage. Similarly, with the possible exception of LTV ratio, we cannot say categorically that an FHA borrower that does not meet any one ratio would not qualify for private mortgage insurance. Also, this analysis does not consider the credit history of a borrower, which lenders and insurers must consider when underwriting a loan. Furthermore, the process of underwriting mortgage insurance requires some judgment on the part of the lender and insurer, and the debt-to-income ratios we employ in this analysis may be exceeded if there are compensating factors.

Finally, there are other features of FHA and private mortgage insurance that may influence a borrower's choice of mortgage insurance. A borrower may have sufficient financial resources to qualify for private mortgage insurance and choose FHA insurance instead so that he or she may invest the funds saved in an asset other than his or her home. Therefore, some FHA borrowers whom we have identified as not being able to qualify for private mortgage insurance on the loan they received may have been able to increase their down payment, thereby lowering their LTV and total-debt-to-income ratios and qualifying for private mortgage insurance on a smaller loan. In its October 1995 report,[15] HUD's Office of Policy and Development found that most of FHA's loans would not have been insured by PMIs because of differences in LTV or noncredit factors, even before the companies considered differences in personal credit history.

About 68 percent of FHA borrowers in 1995 were within the most liberal PMIs' guidelines for LTV ratio (had an LTV ratio less than 97). Conversely, about 32 percent of FHA borrowers in 1995 had LTV ratios that exceeded the maximum allowable LTV ratio under the PMIs' most liberal guidelines. These borrowers with high LTV ratios may not have qualified for private mortgage insurance for the loans they received on the basis of their high LTV ratio alone. Under the PMIs' recently initiated affordable programs, private mortgage insurers will insure loans with LTV ratios of up to 97 percent. Under their standard programs, private mortgage insurers will insure loans with LTV ratios of up to 95 percent. Only 37 percent of FHA borrowers in 1995 had LTV ratios of 95 percent or less, and an additional 31 percent had LTV ratios greater than 95 percent, but not greater than 97 percent. The share of FHA borrowers that had LTV ratios of 95 percent and below and 97 percent and below are shown by the shaded area in figure 3.15.

[15] An Analysis of FHA's Single-Family Insurance Program, pp. ES-3 and 6-26.

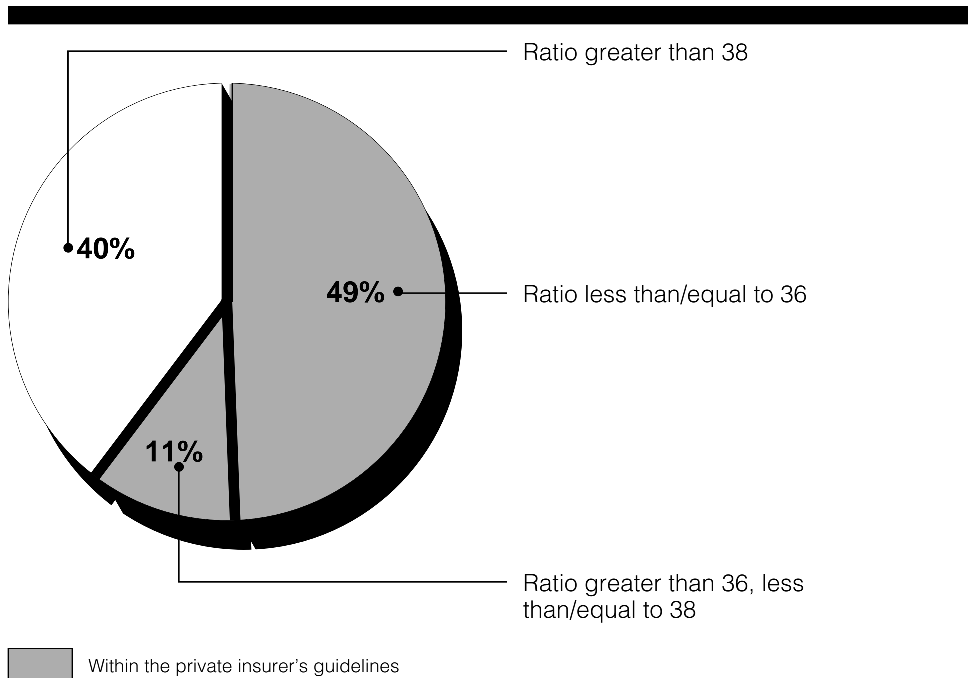
Figure 3.15: Proportion of FHA Home Purchase Loans Made in 1995 That Are Within Private Insurers' Guidelines for Loan-To-Value Ratio



Source: GAO's analysis of FHA's data.

For the ratio of total-debt-to-income, about 60 percent of FHA borrowers in 1995 could meet the most liberal guidelines established by private mortgage insurers. That is, these borrowers had monthly payments for all debt that was not greater than 38 percent of their monthly income. The PMIs' standard programs include guidelines of 36 percent for this ratio. Almost half of the mortgages insured by FHA in 1995 would have met this more restrictive ratio. The share of FHA-insured loans made in 1995 that went to borrowers with ratios of total-debt-to-income no greater than the maximums published by the PMIs is shown as the shaded areas in figure 3.16. As discussed previously, those FHA borrowers that did not meet the PMIs' most liberal guideline for this ratio would not necessarily be precluded from obtaining private mortgage insurance.

Figure 3.16: Proportion of FHA Home Purchase Loans Made in 1995, by Ratio of Total-Debt-To-Income



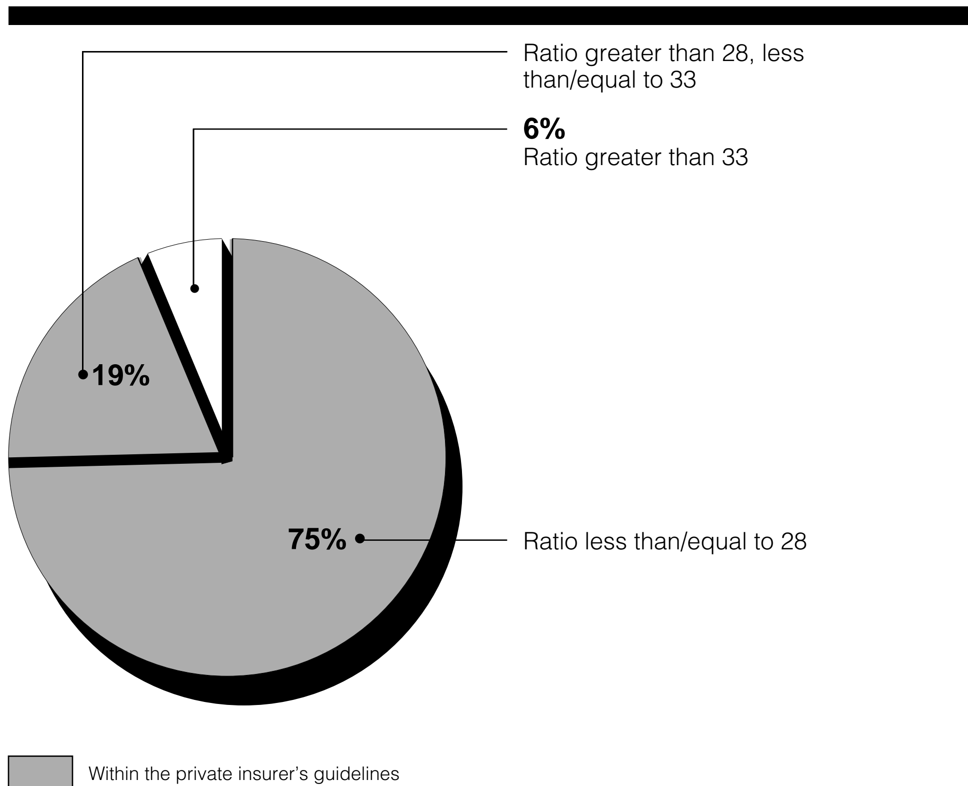
Source: GAO's analysis of FHA's data.

Almost all borrowers that received an FHA-insured mortgage for the purchase of a house in 1995 had ratios of housing-expense-to-income that were within the published guidelines of private mortgage insurers. That is, under the affordable programs of the PMIs, a borrower may have a monthly housing debt up to 33 percent of his or her monthly income. Over 90 percent of FHA borrowers had housing debt that was within this guideline. Under their standard programs, the PMIs' guidelines generally call for a ratio of housing-expense-to-income of no more than 28 percent. Three-quarters of FHA borrowers in 1995 met this guideline.

That nearly all FHA borrowers meet the PMIs' guidelines for housing-expense-to-income is not surprising because the guidelines established by the PMI companies are nearly the same as or more liberal than those of FHA for this particular ratio. The shaded areas of figure 3.17 show those borrowers that received an FHA-insured mortgage in 1995 who would meet the ratio for housing-expense-to-income found in the guidelines of the PMIs. As with the ratio for total debt to income, those FHA

borrowers who did not meet the PMIs' most liberal guideline for housing-expense-to-income would not necessarily be precluded from obtaining private mortgage insurance.

Figure 3.17: Proportion of FHA Home Purchase Loans Made in 1995, by Ratio of Housing-Expense-To-Income



Source: GAO's analysis of FHA's data.

Observations

FHA is a prominent player in the home mortgage loan market—particularly in certain market segments. The loans it insured in 1994 were concentrated to a greater extent on low-income and minority borrowers, first-time home buyers, and borrowers with high LTV ratios than the loans made by the PMIs. FHA was also the primary insurer in at least nine states. In addition, solely on the basis of the LTV and qualifying ratios of borrowers who obtained loans in 1995, most FHA borrowers might not have qualified for private mortgage insurance for the loans they received. Consequently, many FHA borrowers in 1995 may not have been able to

obtain or could have been delayed in obtaining a home mortgage without the more lenient terms offered by FHA.

While FHA is a prominent participant in the home purchase mortgage loan market, it is not the major source of loans to home buyers, nor is it the major source of loans to low-income and minority home buyers. The uninsured market, with about three times the number of loans that FHA had, made about twice as many loans to such borrowers as FHA did in 1994.

Agency Comments

An official in HUD's Office of Policy Development and Research suggested revising the methodology used for some of the analyses described in this chapter. In response, we adjusted our analyses of home purchase loans made in 1994, which used data from HMDA and MICA, to reflect that the HMDA data pertained to about 77 percent of all loans insured in 1994, while the MICA data pertained to all privately insured loans. We also adjusted our analyses to recognize that some loan records in the two data sets were missing geographical location codes and consequently were not being drawn into some analyses.

In response to comments from an Executive Vice President of MICA, we added explanations to this chapter about the federal liability associated with FHA's Section 203(b) program and differences in the way FHA and private mortgage insurers calculate loan-to-value ratios. This official also commented that our report underestimates the (1) percentage of FHA borrowers who would qualify for a privately insured loan because compensating factors may enable a borrower to qualify even if he does not meet the ratios we considered and (2) importance of the role of Fannie Mae and Freddie Mac because it does not present those organizations' criteria for purchasing loans. We disagree with these two comments. First, this chapter describes the limitations of the analyses presented on FHA borrowers who might qualify for private insurance. This analysis was not intended to determine with certainty how many of FHA's borrowers would have qualified for a privately insured loan. To make such a determination would require considering many more factors than loan-to-value and qualifying ratios. Rather, as pointed out in this chapter, our analysis is intended to determine how many of FHA's borrowers might have qualified for private mortgage insurance on the basis of the ratios alone. We point out further in this chapter that we cannot say definitively that an FHA borrower who does not meet all three private mortgage insurance guidelines would not qualify for private insurance. Similarly, if an FHA borrower meets all three private mortgage insurance guidelines, it cannot

be said categorically that a private mortgage insurer would insure the borrower's mortgage. In connection with the roles of Fannie Mae and Freddie Mac, we point out in this report that many guidelines pertaining to private mortgage insurance are set by the two secondary market institutions. We also point out that these requirements include underwriting standards, insurance coverage requirements, and maximum loan amount.

The Federal Government Promotes Affordable Homeownership in Many Ways

Besides the FHA Section 203(b) and VA single-family loan programs described in chapter 2, the federal government promotes affordable homeownership through a complex web of at least 10 programs, through the requirements that it places upon the lenders and purchasers of mortgages and through individual tax incentives. Although these tools differ in their scope and technique, the federal government uses these and other tools to promote homeownership. In comparison with FHA's Section 203(b) program, over half of the other 10 programs require direct federal funds, all reach fewer persons, and they generally direct a greater proportion of assistance to low-income home buyers (income less than/equal to 80 percent of an area's median income). These programs provide home buyers with grants, direct loans, guaranties, interest subsidies, and other assistance in financing a home purchase, and in some instances they rely heavily upon FHA for mortgage insurance. These homeownership programs are run by the Departments of Agriculture, Housing and Urban Development, and Veterans Affairs; the Federal Home Loan Banks; state housing agencies; the Neighborhood Reinvestment Corporation, a government-funded corporation; and Neighborhood Housing Services of America, a government-funded nonprofit organization.[1]

The federal government also promotes affordable homeownership by placing upon certain lenders and the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) special requirements for meeting housing finance needs. Specifically, the Community Reinvestment Act (CRA) encourages depository institutions and other lenders to meet the housing credit needs of the communities they serve, and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 places upon Fannie Mae and Freddie Mac numerical goals for the loans they purchase that are made to low- and moderate-income persons and are made in underserved areas.[2] Because of the difficulties experienced in implementing the CRA and the relative newness of the goals set for Fannie Mae and Freddie Mac, it may be too soon to judge the effect of these special requirements.

[1]In addition, the Federal Deposit Insurance Corporation has a small affordable housing program and administers the former Resolution Trust Corporation's affordable housing program.

[2]In addition, the FHLBank System operates a Community Support Program that, among other things, requires FHLBank members to meet standards of community investment or service in order to maintain continued access to long-term FHLBank System advances. Among other information, a member is required to provide the public disclosure portion of the member's most recent CRA evaluation and a description of how the member assists first-time home buyers.

Finally, through the mortgage interest deduction, one-time exclusion of capital gains, and other tax provisions, the federal government provides incentives for individuals to be homeowners. The Joint Committee on Taxation estimates that, for 1995, the mortgage interest deduction alone was the second largest tax expenditure that the government provides to individuals, totaling an estimated $53.5 billion—exceeding the total tax expenditures given to corporations.[3]

This chapter describes the federal programs that promote affordable homeownership and the applicable requirements recently placed upon Fannie Mae, Freddie Mac, banks, and thrifts. An analysis of the impact on homeownership of making it affordable through tax incentives given to individuals is beyond the scope of this study. Also, this chapter does not describe efforts that support homeownership in general, such as those of the secondary market, the bank system, and the fair lending requirements.

Description of Affordable Homeownership Programs

In addition to the FHA and VA programs, many federal programs aim at affordable homeownership. The state housing finance agencies (HFA), through the use of tax-exempt mortgage revenue bonds (MRB), may provide subsidized financing for affordable homeownership. The Federal Home Loan Bank (FHLBank) System has its Community Investment Program (CIP) and Affordable Housing Program (AHP), which provide subsidies and subsidized or otherwise below-market-rate advances to member institutions to be used to fund affordable housing projects and loans to home buyers. The Department of Agriculture, through the Rural Housing Service (RHS), operates a subsidized direct loan program for low- and very-low income rural Americans and a guaranteed loan program for moderate-income rural Americans. The Department of Housing and Urban Development operates three grant programs—the Community Development Block Grant (CDBG) program, Home Investment Partnership Program (HOME), and Homeownership and Opportunity for People Everywhere that promote affordable homeownership. The Neighborhood Reinvestment Corporation (NRC), through its network of local development organizations called NeighborWorks® organizations (NWO) and its secondary market organization—Neighborhood Housing Services of America (NHSA)—promotes affordable homeownership primarily through second mortgages and home buyer education. (See app. II for detailed descriptions of each program included in our analysis.)

[3]A “tax expenditure” is a reduction in individual and corporate income tax liabilities that result from special tax provisions or regulations that provide benefits to particular taxpayers.

Even within FHA, there are homeownership programs other than the Section 203(b) program. For example, FHA also offers mortgages for individual condominium units under Section 234(c), rehabilitation mortgages under the Section 203(k) program, home equity conversion mortgages under Section 255, and homeownership counseling. The Section 203(b) program, however, is FHA's principal means of promoting affordable single-family homeownership. In 1995, about 60 percent of all FHA single-family mortgages were made under the Section 203(b) program. For the purposes of this chapter, we provide data for all of the federal programs, including the FHA Section 203(b) program, which we use as a guide for describing the other programs.

Type of Assistance Provided by Federal Programs and Their Restrictions

These programs assist homeowners by providing loans, guarantees, interest subsidies, help with down payments and closing costs, or other forms of assistance. This assistance may go directly to the homeowner or through an intermediary, such as a local government or nonprofit organization. A homeowner may benefit from more than one program. For example, HOPE 3 funds may be used to help with closing costs on a loan made by a state HFA. The state HFA may obtain funding from MRBs as well as FHLB System advances. The loan may be insured by FHA and securitized by the Government National Mortgage Association (Ginnie Mae).

Each of the non-FHA/VA homeownership programs include some form of targeting—typically, the income of the borrower. In some cases, the programs also include restrictions on the location of the property, such as with rural loans, or repayment by the borrower of federal subsidies. Only the FHA, VA, and Rural Housing Service single-family loan programs are restricted by the size of the loans that may be insured/guaranteed/made.[4] Table 4.1 describes the type of assistance provided to homeowners and the restrictions imposed by federal homeownership programs.

[4]As noted in chapter 2, lenders generally limit VA loans to four times the VA guaranty amount. Since the maximum VA guaranty is currently legislatively set at $50,750, VA loans will rarely exceed $203,000.

Table 4.1: Type of Assistance and Restrictions for FHA and Other Homeownership Programs

	Assistance provided homeowners				Program restrictions				
Program	Loan	Interest subsidy	Down payment closing help	Other	Income	First-time home buyer	Property location	Recapture of benefits	Other
FHA 203(b)				X[a]					X[b]
FHA non 203(b)	X			X[a,e]					X[i]
VA	X			X[c]					X[d,k]
State MRB/ MCC	X	X		X[a]	X	X		X	X[j]
FHLBs' CIP	X	X			X				
FHLBs' AHP	X	X	X		X			X	
NRC's NWOs	X		X	X[e,f]			X		
NHSA				X[g]			X		
CDBG	X	X	X		X				
HOME	X	X	X		X			X	
HOPE 3		X	X	X[e]	X	X		X	
RHS	X	X		X[c]	X		X		X[b,h]

[a]Mortgage insurance.

[b]Maximum mortgage amount.

[c]Mortgage guarantee.

[d]Limited to veterans.

[e]Home buyer counseling.

[f]Lender referral.

[g]Purchase of loans.

[h]For direct loan, applicant must be unable to secure needed credit from other sources.

[i]Section 255 Home Equity Conversion mortgages are limited to borrowers that are at least 62 years of age.

[j]Principal residence. Purchase price not to exceed 90 percent of the average home price for the area.

[k]Lenders generally limit VA loans to four times the VA guaranty amount, which is set at $50,750. As a result, VA loans rarely exceed $203,000.

Source: GAO's analysis of data from HUD, VA, the National Council of State Housing Agencies, the Federal Housing Finance Board, NRC, and RHS.

Funding Sources

Except for the programs of the Federal Home Loan Banks and the state HFAS—which, like FHA's Section 203(b) loan program, require no direct federal funds—all of the other homeownership programs use federal funds.[5] These federal funds are used to pay for the subsidies and assistance provided and the programs' administration. For example, the VA received $684 million in budget authority for fiscal year 1995 for the subsidy and administrative costs of its direct and guaranteed loan programs. For the same year, the Congress appropriated $50 million for the HOPE programs, of which HUD allocated $20 million to HOPE 3. It appropriated $1.4 billion for the HOME program, of which about $238 million was used for homeownership activities.[6] For the CDBG program, the Congress appropriated $4.8 billion; 70 percent of this amount is for the entitlement cities program. Of this, we estimate that seven-tenths of 1 percent, or about $24 million, may go toward homeownership assistance.[7]

Even the exceptions listed above are not necessarily without costs to the federal government. For example, the AHP and CIP programs of the FHLBank System are paid for through the system's earnings, and according to the Finance Board, no FHLBank has ever suffered losses on its advances. However, the federal government has paid for liquidating insolvent member institutions that had benefited from the use of system advances, and the cost of liquidation may have been higher where advances permitted a troubled institution to incur larger losses than it may have otherwise incurred. Furthermore, the government's past willingness to assist troubled government-sponsored enterprises means that it may bear the costs of most of the losses that such enterprises may suffer in the future. Also, there is a cost to the federal government of the state HFAS' mortgage revenue bond program if one considers the lost revenues resulting from the tax-exempt status of the securities issued by these organizations to fund housing activities. The Joint Committee on Taxation estimates that the tax expenditure for the tax-exempt mortgage revenue bonds for owner-occupied housing was $1.4 billion for fiscal year 1995.

[5]The Section 203(b) program is supported by the Mutual Mortgage Insurance fund, which requires no federal funds to operate. In 1995, the fund had a negative credit subsidy of $309 million. That is, the present value of estimated cash inflows to the federal government exceed the estimated cash outflows. While the Fund's cash reserves have historically covered expenses, if the fund were to deplete its reserves, the U.S. Treasury would have to directly cover lenders' claims and administrative costs.

[6]HOME funds may also be used for rental assistance.

[7]CDBG funds may be used for a variety of eligible activities, including homeownership assistance. We base our estimate of 1995 homeownership funds on the share of expenditures that went to homeownership assistance for program year 1992.

Some of these programs also use nonfederal sources of funds. For example the Neighborhood Housing Services of America (NHSA) receives funding from private-sector, institutional investors through the sale of secondary market notes backed by loans purchased by NHSA. Both the HOME and HOPE 3 programs require matching contributions of 25 percent from nonfederal sources. Through 1995, the Federal Housing Finance Board (FHFB) has approved 23 state HFAS as nonmember mortgagees, which would allow them to obtain advances from the FHLBank System. The source of funds for each homeownership activity, including federal funds where appropriate, is shown in table 4.2.

Table 4.2: Sources of Funds for FHA and Other Federal Homeownership Programs

Program	Actual budget authority for fiscal year 1995 (dollars in millions)	Other sources of funds[a]
FHA 203(b)	None	Insurance premiums
FHA non-203(b)	None	Insurance premiums
VA	$684	Funding fee, loan sales, principal and interest payments
State MRBs	None	Tax-exempt mortgage revenue bonds sold to investors, FHLBank System advances
FHLBs' CIP	None	FHLBank System advances
FHLBs' AHP	None	FHLBank System advances and grants, HOME, HOPE 3, CDBG, state and local government, grants, foundations
NRC's NWOs	$39	CDBG, HOME, HOPE, and state and local government; private-sector contributions; NHSA; also, NWOs may obtain liquidity by selling loans to NHSA
NHSA	[b]	Investors, NRC, private-sector contributions
CDBG	24[c]	Communities may also use funds from other sources
HOME	238[d]	Requires 25 percent matching funds from nonfederal sources
HOPE 3	20[e]	Requires 25 percent matching funds from nonfederal sources
RHS	315[f]	Insurance premiums, principal and interest payments

[a]May not include sources such as interest on revolving loan funds and net proceeds from property disposition activities.

[b]From Neighborhood Reinvestment Corporation funds.

[c]Estimate based on $4.8 billion appropriation, 70 percent for entitlement cities, seven-tenths of 1 percent for homeownership assistance. The share going toward homeownership assistance is based on the share for program year 1992, in which grantees reported that seven-tenths of 1 percent of expenditures went to homeownership assistance ($19.4 million out of $2.6 billion).

[d]Actual fiscal year 1995 budget authority for the entire HOME program was $1.4 billion. HUD advises that $238 million was spent on homeownership.

[e]Based on HUD's allocation of $20 million for the HOPE 3 program from the $50 million appropriation for all HOPE programs.

[f]Does not include administrative expenses associated with single-family programs because administration costs for single-family programs are not recorded separately

Source: GAO's analysis of data from fiscal year 1997 Budget Appendix, HUD, VA, the National Council of State Housing Agencies, the Federal Housing Finance Board, NRC, and RHS.

Number of Home Buyers Assisted and Amount of Assistance

The amount of homeownership assistance provided by other federally supported programs varied widely between programs in terms of the dollars involved and the number of homeowners assisted. In all instances, FHA assisted a greater number of homeowners. In total, in a given year, these other programs may reach over 500,000 homeowners.[8] In 1995, almost 570,000 homeowners received mortgage insurance through FHA insurance programs.[9] During fiscal year 1995, 263,130 homeowners were assisted through the VA's guaranteed loan program. The next greatest number of homeowners assisted was through the state HFAS, which made over 92,000 loans and issued almost 12,000 mortgage credit certificates in 1994, totaling over $9 billion. In contrast, Neighborhood Housing Services of America purchased 1,133 first and second mortgages in fiscal year 1995 totaling $47.7 million; and the HOPE 3 program had assisted 1,396 homeowners as of December 1995.

The characteristics of the home buyers who were assisted were not always available for each of the programs. In general, where data were available, these other programs were more heavily concentrated in assistance provided to homeowners who were low-income, minority, and first-time buyers than was the case for FHA, which balances its risk by insuring a broad range of borrowers and thereby operates without federal subsidies.

- For example, 30 percent of the borrowers insured under FHA's Section 203(b) program had incomes no greater than 80 percent of the area's median income. Sixty-four percent of the homeowners assisted through state HFA mortgages and mortgage credit certificates and 69 percent of new homeowners assisted by the Neighborhood Reinvestment Corporation programs had low incomes. For the entitlement cities part of the Community Development Block Grant program and the HOME programs, the percentage of homeowners assisted who had low incomes was 94 and 100, respectively. For the Federal Home Loan Banks' Affordable Housing Program and the HOPE 3 program, all homeowners assisted must have incomes no greater than 80 percent of the area's median income.
- In connection with the race of the homeowners assisted through these various programs, all of the programs with available data served proportionately more minorities than did FHA, with the exception of the state and RHS programs. For example, while about 30 percent of the

[8]It is difficult to estimate the total number of homeowners assisted because individuals may benefit from more than one program. The number presented here is overstated by an unknown amount.

[9]Includes refinancings. However, over 90 percent of the single-family mortgages insured by FHA in 1995 were home purchase mortgages. In this chapter, we report total loans.

borrowers insured under the FHA Section 203(b) program were minorities, the state and RHS programs' percentages were about 22 and 27, respectively, and the NRC, CDBG, HOME, and HOPE 3 programs' percentages were 61, 65, 50, and 62, respectively.

- There were very few data on the percentage of assisted homeowners who were first-time home buyers. With the exception of the VA program, the other programs for which data were available reported higher percentages of first-time home buyers. The NRC reported that 97 percent of the homeowners assisted by NWOs were first-time home buyers. For the HOPE 3 program, all assisted homeowners must be first-time home buyers, and for the state MRB/MCC programs, applicants may not have owned a home in the last 3 years. For FHA's Section 203(b) program, about 61 percent of the borrowers insured were first-time home buyers. Just over half of VA borrowers were first-time home buyers. (See table 4.3)

Table 4.3: Number and Characteristics of Homeowners Assisted Through the FHA and Other Homeownership Programs

Program	Number of homeowners assisted	Amount of loans and other assistance homeowners received (dollars in millions)[a]	Characteristics of home owners assisted (percent)			Year
			Low income[b]	Minority	First-time buyer	
FHA 203(b)	334,079	$25,950.3	29.9	29.4	61.3	CY 95
FHA non 203(b)	234,766	19,118.9	42.9	30.5	65.5	CY 95
VA	263,130	25,340.9	NA	NA	51.1	FY 95
State MRB/MCC	104,520	9,168.8	64.3	21.9	100[c]	CY 94
FHLBs' CIP	82,907	3,800.0	NA[d]	NA	NA	CY 95
FHLBs' AHP	10,241	48.0	100[c]	NA	NA	CY 95
NRC's NWOs	7,184[e,f]	295.1	69.0	61.0	97.0	FY 95[g]
NHSA	1,133[e]	47.7	[h]	[h]	[h]	FY 95
CDBG	18,325[e,i]	19.4	93.9	65.1	NA	PY 92[j]
HOME	18,898	237.9	100	50.2	NA	FY 95
HOPE 3	1,396	23.0	100[c]	62.0	100[c]	CY 95
RHS	32,082[k]	1,982.7	61.8	26.6	NA	FY 95

Notes: NA - not available; CY - calendar year; FY - fiscal year; PY -program year.

[a]Amounts here may differ from those reported in the fiscal year 1997 Budget Appendix.

[b]Income not exceeding 80 percent of the area's median.

[c]Based on program requirement.

[d]Borrowers assisted under the CIP program may not have income exceeding 115 percent of the area's median.

[e]Some data on number of homeowners assisted may over-count where a homeowner receives more than one type of assistance.

[f]Includes 2,854 rehabilitation loans and 4,330 first mortgages. Over half of first mortgages would also have a rehabilitation loan (averaging between $7,000 to $8,000).

[g]Data on homeowners' characteristics are for the 36-month period ending December 1995.

[h]Characteristics should be similar to those for NRC/NWOs, whose loans NHSA purchases.

[i]Includes 8,000 persons and 10,325 households that obtained homeownership assistance directly from the grantee and/or indirectly from a subrecipient of the grantee.

[j]Program year.

[k]Includes 15,405 direct loans and 16,677 guaranteed loans.

Source: GAO's analysis of data from HUD, VA, the National Council of State Housing Agencies, the Federal Housing Finance Board, NRC, and RHS.

Use of Mortgage Insurance

The extent to which each of the non-FHA programs utilizes mortgage insurance is not completely known. Three programs provide mortgage insurance or a similar enhancement: VA and the Rural Housing Service guarantee mortgages, and seven state HFAS self-insure mortgages. Loans made by state HFAS are almost always insured, mostly by FHA. In 1994, FHA insured over 55 percent of the loans made by state HFAS. VA accounted for over 8 percent. While there were no data on the extent to which homeowners assisted through the FHLBS' AHP and CIP programs had mortgage insurance, because member institutions may keep loans in their portfolio, they may not require mortgage insurance on these loans. The use of mortgage insurance on individual loans made by NWOS was not known, but both GE Capital Mortgage Corporation and Mortgage Guaranty Insurance Corporation provide mortgage insurance on special loan products offered through the NeighborWorks® Campaign for Home Ownership that allow for higher LTV ratios. Furthermore, the PMI Mortgage Insurance Company, provides pool insurance for first loans purchased from the Neighborhood Housing Services of America by the World Savings and Loan Association. The use of mortgage insurance in relation to two of HUD's grant programs—CDBG and HOME—is not known. For the HOPE 3

program, about 19 percent of home buyers financed their home purchases using FHA insurance.

Description of Requirements Placed on Major Housing Finance Participants

The Federal government also promotes affordable homeownership through requirements that it places upon lenders and purchasers of mortgages. Specifically, the Community Reinvestment Act encourages certain lenders to meet the credit needs of the areas that they serve, including low- and moderate-income areas; and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 contains provisions that require Fannie Mae and Freddie Mac to meet certain goals related to the purchase of mortgages made to low- and moderate-income borrowers and in areas of low- and moderate-income. Both the lenders and Fannie Mae and Freddie Mac have taken actions to better meet the credit needs of low- and moderate-income home purchasers. However, given the difficulties experienced in implementing the CRA, and the relative newness of the social goals, it may be too soon to judge the impact these requirements will have on affordable homeownership.

The CRA's Requirements

The Congress in 1977 enacted the CRA to encourage banks to provide credit to their entire market areas, including low- and moderate-income areas. The CRA requires federal bank and thrift regulators—the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision—to evaluate during periodic examinations the extent to which banks are fulfilling their lending, investment, and service responsibilities to their areas. In connection with lending, the regulator evaluates a bank's record of helping to meet the credit needs of its area through its lending activities by looking at such indicators as the geographic distribution of the bank's loans, including the incomes of areas and borrowers and the extent to which the bank uses innovative or flexible lending practices. On the basis of the results of these assessments, the regulators assign the banks one of four overall CRA ratings, ranging from "outstanding" to "substantial noncompliance." The CRA is limited to depository institutions, such as banks and thrifts. These institutions originated about 46 percent of all home mortgages made in 1994. Mortgage companies—the primary providers of mortgages for single-family homes in 1994—are not subject to the CRA.

An institution's CRA rating may affect approval by the regulators of certain types of applications, an institution's access to FHLB advances, and the

public's perception of the institution. The regulators are required to take a depository institution's CRA rating into account when considering applications for expansions, such as mergers and acquisitions. In addition, a FHLBank System member's access to the long-term advances used to finance residential mortgage lending is tied, in part, to its CRA rating. An institution's CRA rating and related information must also be available to the public for review. Finally, the CRA affords community groups or other members of the public the opportunity to protest an institution's application for establishing a deposit facility.

The CRA and the fair lending laws have related objectives. The primary purpose of the CRA was to prohibit "redlining"—arbitrarily failing to provide credit to low-and moderate-income neighborhoods. The Fair Housing Act and the Equal Credit Opportunity Act prohibit lending discrimination that is based on certain characteristics of the potential and actual borrowers. In addition, the Home Mortgage Disclosure Act (HMDA) provides regulators and the public with information on mortgage applications. In November 1995, we issued a report analyzing the implementation of the CRA.[10]

Impact of the CRA

Because of difficulties in implementing the CRA and the relative newness of reforms intended to address these difficulties, it may be too soon to judge the impact of the CRA. Yet even with the disagreements over the implementation of the CRA, bank and thrift regulators report some actions taken to better meet the needs of underserved communities. In connection with difficulties in implementing the CRA, we reported in November 1995 that because of the concerns of those lenders subject to the CRA about the burden it presents and the concern of community groups about the enforcement of the CRA, the regulators responsible for enforcing the CRA undertook a series of public hearings in 1993 and revised the regulations for the CRA in May 1995. We reported that some of the difficulties that have hindered past efforts to implement the CRA—differences in examiners' training and experience, insufficient information to assess institutions' CRA performance, and insufficient time for examiners to complete their responsibilities—will likely continue to challenge the regulators as they implement the revised regulations.

According to bank and thrift regulators, despite the difficulties in implementing the CRA, it has played an increasingly important role in

[10]Community Reinvestment Act: Challenges Remain to Successfully Implement CRA (GAO/GGD-96-23, Nov. 28, 1995).

improving access to credit in communities, and many banks and thrifts, under the impetus of the CRA, have opened new branches, provided expanded services, and made substantial commitments to increase lending to all qualified borrowers within their areas. As we reported in November, some bankers may lower the relatively high transaction costs and perceived credit risks to individual institutions of community reinvestment loans by sharing those costs and risks through multi-institution programs. Regulators found that bankers who had effective CRA performance had undertaken initiatives such as borrower education and counseling, community outreach efforts, flexible underwriting standards or policies, and participation in government-sponsored lending programs. In addition, some major participants in the secondary markets have recently undertaken initiatives intended to make them more responsive to community development concerns, as discussed in the following section.

Government-Sponsored Enterprises Have Required Social Goals

The secondary mortgage market is the market in which mortgages and mortgage-backed securities are bought and sold. The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation are government-sponsored enterprises that operate a secondary mortgage market in which they purchase mortgages from lenders in exchange for cash or mortgage-backed securities/participation certificates.

The mortgages that Fannie Mae and Freddie Mac may purchase are limited to those in amounts less than a legislative limit known as the conforming loan limit. This limit is adjusted on the basis of a formula; for 1996, the limit is $207,000 for single-unit, single-family residences. In addition, the GSEs are restricted to purchasing and securitizing only residential mortgages, are obligated to be active in the secondary market across the country at all times, and must comply with capital requirements and safety and soundness regulations issued by the Office of Federal Housing Enterprise Oversight. The GSEs face these restrictions on their activities for the benefits of their federal charter. An important indirect benefit is that investors perceive an implied federal guarantee on their obligations, which allows Fannie Mae and Freddie Mac to borrow at near-Treasury rates.[11] Direct benefits include (1) $2.25 billion in conditional lines of credit with the Department of the Treasury, (2) exemptions from state and local corporate income taxes, and (3) exemptions from the Securities and Exchange Commission's registration requirements for their securities. In addition to Fannie Mae and Freddie Mac, the secondary mortgage market is served by the Government National Mortgage Association (limited to

[11]FNMA and FHLMC: Benefits Derived From Federal Ties: (GAO/GGD-96-98R, Mar. 25, 1996).

securitizing federal government insured/guaranteed loans) and private conduits (private companies that purchase mortgages and sell mortgage-backed securities). In the first quarter of 1995, about 48 percent of outstanding single-family mortgage debt was held in mortgage pools. Fannie Mae and Freddie Mac accounted for about 62 percent this debt, Ginnie Mae for 27 percent, and private conduits for about 11 percent.

A Description of the Requirements

The Congress requires Fannie Mae and Freddie Mac to support mortgage lending for low- and moderate-income persons and for residents of areas where home loans may be difficult to obtain. Their charters charge the GSEs with providing ongoing assistance to the secondary market for home mortgages—including the market for mortgages for low-and moderate-income families. More recently, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 required the Secretary of HUD to establish housing goals for Fannie Mae's and Freddie Mac's purchases of mortgages for low- and moderate-income families; housing located in central cities, rural areas, and other underserved areas; and special affordable housing meeting the unaddressed housing needs of targeted families.[12] The act established interim annual goals for the 2-year period beginning on January 1, 1993. These annual goals were that (1) 30 percent of the total number of dwelling units financed by the mortgage purchases of the enterprise shall be for low- and moderate-income families;[13] (2) 30 percent of the total number of dwelling units financed by the mortgage purchases of the enterprise shall be mortgages on properties located in central cities; and (3) the mortgage purchases of Fannie Mae shall include not less than $2 billion ($1.5 billion for Freddie Mac) in "special affordable" mortgages, split evenly between mortgages on single-family and multifamily housing.[14]

In October 1993, HUD published interim goals for the GSEs, setting the low- and moderate-income goal for Fannie Mae at 30 percent for 1993 and 1994.

[12]Although the authority to establish goals previously existed under the Charter Act and was implemented under regulations, the 1992 legislation defined and expanded this authority and defines the goals in terms of borrower/renter income rather than house price.

[13]In general, low-income is defined as family income not in excess of 80 percent of an area's median family income. Moderate income is defined as family income not in excess of the area's median income. In the case of rental units, the Secretary may adjust median income for smaller and larger families.

[14]For single-family mortgages to be counted toward the special affordable target, they must be made to (1) low-income families who live in census tracts in which the median incomes do not exceed 80 percent of the areas' median incomes or (2) very-low-income families without regard to where they live. For multifamily mortgages to be counted toward the special affordable target, they must meet similar tests.

The goal for Freddie Mac was 28 percent for 1993 and 30 percent for 1994. HUD set the central cities goal for 1993 at 28 percent for Fannie Mae and 26 percent for Freddie Mac. Both had a goal of 30 percent for 1994. The goals for 1995 were kept at the level for 1994. The goals for 1993, 1994, and 1995 are shown in table 4.4.

Table 4.4: Fannie Mae's and Freddie Mac's Affordable Housing Goals for 1993, 1994, and 1995

	Fannie Mae		Freddie Mac	
Year	Goal	Actual	Goal	Actual
Low- and moderate-income goals (percent of dwelling units financed)				
1993	30	36	28	29
1994	30	46	30	38
1995	30	46	30	39
Central cities goals (percent of dwelling units financed)				
1993	28	26	26	24
1994	30	32	30	25
1995	30	30	30	23
Special affordable housing goals (dollars in billions)				
1993-94 (single-family)	12.4	16.7	11.1	12.2
1993-94 (multifamily)	3.7	4.5	0.8	0.5
1995 (single-family)	3.4	6.2	3.0	4.4
1995 (multifamily)	1.2	2.2	0.4	1.1

Source: HUD, Fannie Mae, Freddie Mac.

In February 1995, HUD proposed goals to increase Fannie Mae's and Freddie Mac's affordable housing purchase requirements. HUD issued the final regulations in December 1995, specifying, among other things, the goals for 1996. The goals for 1996 increased to 40 percent the portion of dwelling units for low- and moderate-income borrowers. The regulations set at 21 percent the central cities housing goal for 1996 and expanded the areas to be included in this goal to include rural and other underserved areas along with central cities. The special affordable housing goal for 1996 required that 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases are to be in mortgages for

low-income families in low-income areas and very-low income families.[15] Table 4.5 shows the affordable housing goals for 1996.

Table 4.5: Fannie Mae's and Freddie Mac's Affordable Housing Goals for 1996

Fannie Mae	Freddie Mac
Low- and moderate-income goals (percent of dwelling units financed)	
40	40
Central city, rural, and other underserved areas (percent of dwelling units financed)	
21	21
Special affordable housing goals (percent of dwelling units financed)	
12	12

Impact of Social Goals

In terms of what loans the GSEs purchase, an increasing proportion were made to persons in targeted income groups and locations during the first 2 years of the social goals. However, it may be too soon to judge the impact that the social goals ultimately may have. According to HUD's data, the GSEs purchased a greater proportion of loans made to low- and moderate-income persons in 1994 than they did in 1993—up 10 percentage points for Fannie Mae and 9 percentage points for Freddie Mac. The same is true for loans made in central cities—up 6 percentage points for Fannie Mae and 1 percentage point for Freddie Mac. HUD further reports that the increases made in these goals appear to have been made without significant adverse impact on the GSEs' financial condition.[16] With the exception of the 1993 goal for central cities, Fannie Mae has exceeded its goals for 1993 and 1994. Freddie Mac was unable to meet the central cities goal for both years and was unable to meet the special affordable housing goal for multifamily housing for the period 1993 through 1994. For 1995, Fannie Mae met or exceeded each of its housing goals, and Freddie Mac exceeded the low- and moderate-income and special affordable housing goals but did not meet the goal for loans in central cities.

In recent years, both GSEs have undertaken efforts to make more flexible their underwriting guidelines and develop new loan products that require less cash to obtain a home. For example, Fannie Mae's Community Home Buyer's Program allows borrowers to make a down payment of 5 percent from their own funds and to qualify with housing expense and total debt ratios of 33/38 (or higher with compensating factors). Fannie Mae recently

[15]The goal includes mortgage purchases financing dwelling units in multifamily housing totaling not less than 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994.

[16]Annual Report to Congress, 1995, Office of Federal Housing Enterprise Oversight, June 15, 1995.

added the Fannie 97 mortgage product to its community lending product line. Borrowers need only a 3 percent down payment from their own funds; family members, nonprofit groups, or government agencies are eligible to pay the closing costs. For a 30-year term, the qualifying ratios for a Fannie 97 mortgage product are the same as for the standard product—28/36. Freddie Mac's Affordable Gold program provides for 95-percent LTV ratio loans with what is called a 3/2 option. Under this option, borrowers need only 3 percent of the value of the loan from their funds, with the remaining 2 percent from a gift, a grant, or an unsecured loan. In connection with qualifying ratios, Freddie Mac's affordable program has no maximum housing expense ratio, and the total debt ratio is 38 to 40. Both GSEs require home buyer counseling for certain affordable products.

Relationship to Mortgage Insurance

A lender wishing to sell a loan to either of the GSEs must meet the GSEs' underwriting standards. Those standards require credit enhancement—typically, mortgage insurance—for loans with LTV ratios greater than 80. The lender selects a mortgage insurer from those that are approved by the GSEs. Any of the loans with high LTV ratios that are part of the effort to reach low- and moderate-income borrowers and borrowers located in central cities and other underserved areas require mortgage insurance or other credit enhancement. However, as is the case with Fannie Mae's portfolio in general, about two-thirds of the loans counted toward the social goals had LTV ratios of 80 percent or less and therefore generally would not require mortgage insurance. Specifically, Fannie Mae reports that for 1995, 65 percent of the dwelling units that counted toward the low- and moderate-income goal had LTV ratios of 80 percent or less. For the central city goal, the percentage was 64 percent, and for the special affordable goal, it was 64 percent. In comparison, about 65 percent of all mortgages acquired by Fannie Mae had LTV ratios of 80 percent or less. For Freddie Mac, the percentage of loans that counted toward the social goals varied; there were relatively more loans with LTVs below 80 percent and which therefore would not require mortgage insurance. Specifically, for Freddie Mac the percentage of units that counted toward the three goals in 1995 and had LTV ratios of 80 percent or less were 74, 67, and 79. The percentage of all mortgages acquired by Freddie Mac that had LTV ratios of 80 percent or below was 70 percent in 1995.

In comparison with the total mortgages acquired, Fannie Mae had relatively more of its loans that counted toward its social goals with LTV ratios above 90 percent, while Freddie Mac had relatively fewer for two of

the social goals. Overall, 17.9 percent of single-family mortgages purchased by Fannie Mae in 1995 had LTV ratios above 90 percent. For Freddie Mac, the number was 13.5 percent. While Fannie Mae purchased in 1995 few loans with LTV ratios above 95 percent, relatively more of these loans counted toward the social goals. Specifically, while 2.2 percent of the loans Fannie Mae purchased in 1995 had LTV ratios greater than 95 percent, the proportion of loans that counted toward the low- and moderate-income, central cities, and special affordable housing goals and for which the LTV of the loan was greater than 95 percent, were 5.4, 2.9, and 6.1 percent, respectively.[17] Freddie Mac purchased nearly no loans with LTV ratios above 95 percent in 1995; none were counted toward the social goals.

Observations

Of the programs used by the federal government to promote affordable homeownership, FHA's Section 203(b) mortgage insurance program reaches more homeowners than does any other program; and in some instances, FHA's insurance is used in conjunction with other programs. Where the use of mortgage insurance is known, two of the other programs used FHA mortgage insurance—in one instance for 60 percent of the loans made and in another instance for 19 percent of the buyers assisted. However, according to available data, FHA's program in many instances is not as focused on low-income and minority homeowners and first-time home buyers as are the other nine programs. While the other programs are generally more targeted to these underserved borrowers, they often have a cost to the federal government. In contrast, the costs of FHA's Section 203(b) program are paid by the program's participants and not by the U.S. Treasury. In comparison with all of these programs, the requirements placed upon certain lenders and purchasers of mortgages may have the greatest potential for promoting affordable homeownership, although the extent to which these requirements affect lenders' behavior is not clear. Finally, the most pervasive government incentive for homeownership—though not targeted to low-income home buyers—is the deduction of the interest on home mortgages from an individual's taxable income.

Agency Comments

In response to comments from the Managing Director of the FHFB, we made a number of revisions, including clarifying our discussion of the potential federal government liability associated with advances provided

[17]Fannie Mae first announced its program for the purchase of loans with LTV ratios of 97 percent in November 1994.

by FHLB to member institutions. However, in contrast with the Managing Directors' comments, we continue to believe that there is a potential federal cost associated with such advances because the federal government has paid for liquidating insolvent member institutions. Although the federal government has incurred no direct costs due to FHLB advances, the costs the federal government could incur for liquidating insolvent member institutions may be higher when member institutions have been provided additional resources for lending through the advances. In addition, government sponsorship of the FHLBank System creates potential liabilities for the federal government. For these reasons, we retained the discussion of this potential cost in our report.

Data for the Figures in Chapters 1 and 3

Table I.1: Insured and Uninsured Home Purchase Mortgages as a Percentage of All Originations, 1984-94 (Figure 1.1)

	Current dollars in billions			Percentage of dollar value of all originations		
Year	Insured	Uninsured	Total	Insured	Uninsured	Total
1984	$92.027	$111.678	$203.705	45	55	100
1985	$94.488	$195.296	$289.784	33	67	100
1986	$134.057	$365.355	$499.412	27	73	100
1987	$152.473	$354.758	$507.231	30	70	100
1988	$102.194	$344.069	$446.263	23	77	100
1989	$95.906	$357.001	$452.907	21	79	100
1990	$120.660	$337.744	$458.404	26	74	100
1991	$116.196	$445.878	$562.074	21	79	100
1992	$175.865	$717.817	$893.681	20	80	100
1993	$261.247	$758.615	$1,019.861	26	74	100
1994	$274.485	$494.243	$768.728	36	64	100

Source: HUD, "U.S. Housing Market Conditions," August 1995.

Table I.2: All Insured Home Purchase Mortgages, by Insurer, 1984-94 (Figure 1.2)

Year	Percent insured By FHA	Percent insured by PMI companies	Percent insured by VA	Total
1984	18	69	13	100
1985	30	53	16	100
1986	48	34	17	100
1987	51	29	20	100
1988	46	39	16	100
1989	47	39	14	100
1990	50	32	18	100
1991	40	46	13	100
1992	29	57	14	100
1993	32	52	16	100
1994	35	48	18	100

Source: HUD, "U.S. Housing Market Conditions," August 1995

Table I.3: Number of Mortgages Issued in 1994, by Type of Insurer (Figure 3.1)

Type of insurer	Total	Home purchase	Refinance	Percent of home purchase
Uninsured	4,111,663	2,069,974	2,041,689	58.48
PMI[a]	883,669	725,188	158,481	20.49
FHA	722,342	519,102	203,240	14.67
VA	333,926	218,052	115,874	6.16
RHS	7,723	7,215	508	0.20
Total	**6,059,323**	**3,539,531**	**2,519,792**	**100**

[a]Mortgage Insurance Companies of America's data on private mortgage insurer (PMI) loans were adjusted to compare with data from the Home Mortgage Disclosure Act (HMDA) data. HMDA data include approximately 77 percent of all home purchase loans. MICA's data, however, include nearly all loans insured by PMIs. To determine the relative share of the market of loans in the HMDA database held by FHA and PMIs, MICA's data were reduced by 23 percent.

Source: GAO's analysis of data obtained from HUD and through HMDA and from MICA.

Table I.4: Number of Home Purchase Mortgages Issued in 1994 to Low-, Middle- and High-Income Borrowers, by Type of Insurer (Figures 3.2 and 3.3)

Income type[a]	Total	FHA	PMI[b]	RHS	VA	Uninsured
High	1,287,401	108,072	269,724	788	57,443	851,374
Middle	1,157,331	190,679	277,823	3,223	86,808	598,798
Low	1,094,798	220,351	177,641	3,204	73,801	619,802
Percent low income	30.93	42.45	24.50	44.41	33.85	29.94
Total	**3,539,531**	**519,102**	**725,188**	**7,215**	**218,052**	**2,069,974**

[a]We defined borrower's income as "low" if it is at or below 80 percent of the Metropolitan Statistical Area's (MSA) median family income, "middle" if it is greater than 80 percent but at or below 120 percent of the MSA median, and "high" if it is greater than 120 percent of the MSA median.

[b]The relative percentages of PMI loans in the high-, middle-, and low-income groups as reported in the MICA data were applied to our estimate of the number of home purchase loans insured by PMIs and included in the HMDA data.

Source: GAO's analysis of data from HMDA, MICA, and HUD.

Table I.5: Proportion of Insurers' 1994 Home Purchase Mortgages in Various Income Groups (Figure 3.4)

Income	Uninsured percent	FHA percent	PMI percent	VA percent
$0- $20,000	5.91	4.38	1.24	3.59
$20,001-$30,000	11.81	19.14	7.51	13.55
$30,001-$40,000	14.38	27.46	14.82	24.63
$40,001-$50,000	13.65	22.52	18.28	22.55
$50,001-$60,000	11.98	13.58	16.99	16.19
$60,001-$80,000	16.88	9.45	22.58	14.33
$80,001-$100,000	9.45	2.07	10.00	3.63
$100,001-$200,000	12.41	1.21	7.91	1.41
$200,001-$300,000	2.05	0.11	0.48	0.06
$300,000	1.48	0.08	0.19	0.07
Total	**100.00**	**100.00**	**100.00**	**100.00**

Note: Conventional loans reported in GAO's analysis of data from HMDA were divided between the PMIs and the uninsured loans on the basis of (a)the total number of loans identified with income data and (b)adjustments to the total number of PMI loans reported by MICA to account for the under-count in the HMDA data as described in the note to table I.3.

Source: GAO's analysis of data from HMDA and MICA.

Table I.6: Number of Home Purchase Mortgages Made in 1994, by Race of Borrowers and by Insurer (Figures 3.5 and 3.6)

Race of borrower	Uninsured	FHA	PMI	VA	Total
Minority	303,477	147,423	114,197	48,453	613,550
Nonminority	1,766,497	371,679	610,991	169,599	2,918,766
Total	2,069,974	519,102	725,188	218,052	3,532,316
Percent[a] minority	14.66	28.40	15.75	22.22	17.37
Percent of minority	49.46	24.03	18.61	7.90	100.00

[a]Percent minority is the proportion of each group's loans that is identified as minority. Percent of minority is the percent of all minority loans that are insured by each group.

Source: GAO's analysis of data from HMDA and MICA.

Table I.7: Number of Home Purchase Mortgages Made to First-Time Home Buyers in 1994 (Figures 3.7 and 3.8)

	Total loans	Number of first-time home buyers
FHA	686,487	459,851
Non-FHA	3,888,652	1,695,039
Total	**4,575,139**	**2,154,890**

Source: Data from the Mortgage Bankers Association.

Table I.8: Number of 1993 Home Purchase Mortgages Reported in the American Housing Survey, by Age of Borrowers and by Insurer

Age	Conventional	FHA	VA
30 & below	142,757	19,073	5,040
At least 30 & less than 40	828,055	148,895	38,116
At least 40 & less than 50	882,682	58,288	19,236
At least 50 & less than 60	447,353	40,649	16,424
At least 60 & less than 75	227,390	4,861	4,385
75 & over	19,805	0	0
Total	**2,548,042**	**271,766**	**83,201**

Note: The 1993 AHS survey took place between July and December of 1993. The data include home purchase mortgages received in 1993 prior to the survey.

Source: GAO's analysis of the American Housing Survey's 1993 data.

Table I.9: Number of Home Purchase Mortgages Made in Each State in 1994, and Market Share Held by PMIs, FHA, and VA (Figure 3.9)

	Number of insured loans				Percent of total held by the insurers		
State	PMI	FHA	VA	Total	PMI	FHA	VA
AL	8,820	6,289	3,266	18,375	48	34	18
AK	1,293	1,214	1,396	3,903	33	31	36
AZ	17,122	15,273	6,143	38,538	44	40	16
AR	2,793	4,320	1,659	8,772	32	49	19
CA	75,741	50,612	17,603	143,956	53	35	12
CO	18,090	16,716	6,870	41,676	43	40	16
CT	8,018	5,361	990	14,369	56	37	7
DE	3,001	1,071	593	4,665	64	23	13
DC	1,708	944	202	2,854	60	33	7
FL	48,714	29,982	14,303	92,999	52	32	15
GA	25,875	15,113	6,233	47,221	55	32	13
HI	1,475	1,203	327	3,005	49	40	11
ID	3,074	2,106	846	6,026	51	35	14
IL	42,972	20,967	4,450	68,389	63	31	7
IN	19,169	11,003	3,157	33,329	58	33	9
IA	9,280	1,821	761	11,862	78	15	6
KS	8,550	3,551	1,844	13,945	61	25	13
KY	6,936	4,136	1,653	12,725	55	33	13
LA	7,872	6,641	2,557	17,070	46	39	15
ME	1,536	729	428	2,693	57	27	16
MD	16,138	16,531	6,736	39,405	41	42	17
MA	19,140	4,069	1,884	25,093	76	16	8
MI	36,302	15,560	3,491	55,353	66	28	6
MN	14,931	16,067	3,181	34,179	44	47	9
MS	3,401	3,334	1,183	7,918	43	42	15
MO	15,418	9,502	2,690	27,610	56	34	10
MT	999	1,232	423	2,654	38	46	16
NE	3,948	2,275	1,160	7,383	53	31	16
NV	5,070	5,633	2,965	13,668	37	41	22
NH	2,520	1,245	598	4,363	58	29	14
NJ	23,034	10,910	3,061	37,005	62	29	8
NM	4,373	2,264	1,440	8,077	54	28	18
NY	30,067	17,254	3,431	50,752	59	34	7
NC	20,363	10,327	8,038	38,728	53	27	21
ND	851	1,283	252	2,386	36	54	11

(continued)

State	Number of insured loans				Percent of total held by the insurers		
	PMI	FHA	VA	Total	PMI	FHA	VA
OH	37,143	14,664	5,045	56,852	65	26	9
OK	6,174	6,514	3,234	15,922	39	41	20
OR	11,539	4,006	1,563	17,108	67	23	9
PA	28,655	12,662	3,706	45,023	64	28	8
RI	2,995	1,425	443	4,863	62	29	9
SC	10,033	4,079	2,569	16,681	60	24	15
SD	1,096	987	558	2,641	41	37	21
TN	10,743	14,473	4,601	29,817	36	49	15
TX	53,252	33,222	19,505	105,979	50	31	18
UT	6,631	7,181	1,513	15,325	43	47	10
VT	503	161	146	810	62	20	18
VA	20,460	17,243	12,696	50,399	41	34	25
WA	19,016	10,099	7,999	37,114	51	27	22
WV	2,017	840	433	3,290	61	26	13
WI	17,304	1,899	1,969	21,172	82	9	9
WY	1,132	790	411	2,333	49	34	18
Total	**737,287[a]**	**446,783**	**182,205**	**1,366,275**	**54**	**33**	**13**

[a]204,516 (941,803 total PMI loans less 737,287 identified in states) of all PMI loans within the MICA data, and 72,319 (519,102 total FHA loans less 446,783 identified in states) FHA loans within the HMDA data did not have a state code or contained edit failures. When the adjustments for under-count in the HMDA data and to account for missing state codes and edit failures are made, we find that an additional four states may have been primarily insured by FHA (Arizona, Colorado, Mississippi, and South Dakota). Two other states (Louisiana and Virginia) are estimated to have the same percentage of home purchase loans insured by PMIs and FHA.

Source: GAO's analysis of HMDA's and MICA's data.

Table I.10: Distribution of 1994 FHA and PMI Home Purchase Mortgages, by LTV (Figures 3.10, 3.11 and 3.12)

LTV level	Percent of FHA loans	Percent of PMI[a] loans
Greater than 80 but not more than 85	2.36	5.33
Greater than 85 but not more than 90	8.72	40.11
Greater than 90 but not more than 95	23.16	47.19
Greater than 95 but not more than 97	33.44	1.68
Greater than 97 but not more than 100	31.87	5.68

[a]Conventional loans with LTVs above 80 percent.

Source: GAO's analysis of Federal Housing Finance Board's and FHA's data.

Table I.11: Distribution of VA Home Purchase Mortgages, by Loan-To-Value Ratio, in 1994 (Figure 3.13)

LTV level	Percent of VA loans
Greater than 81 but not more than 86	1.77
Greater than 86 but not more than 91	4.54
Greater than 91 but not more than 95	7.28
Greater than 95 but not more than 97	5.26
Greater than 97	81.15

Source: GAO's analysis of VA's 1994 data.

Table I.12: Number and Percent of FHA Single-Family Home Purchase Mortgages Made in 1995 That Are Within PMI Guidelines for LTV Ratio, and Ratios of Total-Debt-To-Income and Housing-Expense-To-Income (Figure 3.14)

	Number of loans	Percentage of all loans
Within guidelines	176,500	34.1
Not within guidelines	340,412	65.9
Total (all loans)	**516,912**	**100.0**

Source: GAO's analysis of HUD's data.

Table I.13: Number and Percent of FHA Single-Family Home Purchase Mortgages Made in 1995 That Are Within PMI Guidelines for LTV Ratio (Figure 3.15)

	Number of loans	Percentage of all loans
Ratio less than/equal to 95	180,475	37.4
Ratio greater than 95, less than/equal to 97	148,630	30.8
Ratio greater than 97	153,547	31.8
Total (all loans)	**482,652**	**100.0**

Source: GAO's analysis of HUD's data.

Table I.14: Number and Percent of FHA Single-Family Home Purchase Mortgages Made in 1995, by Ratio of Total-Debt-To-Income (Figure 3.16)

	Number of loans	Percentage of all loans
Ratio less than/equal to 36	231,012	49.3
Ratio greater than 36, less than/equal to 38	51,227	10.9
Ratio greater than 38	186,699	39.8
Total (all loans)	**468,938**	**100.0**

Source: GAO's analysis of HUD's data.

Table I.15: Number and Percent of FHA Single-Family Home Purchase Mortgages Made in 1995, by Ratio of Housing-Expense-To-Income (Figure 3.17)

	Number of loans	Percentage of all loans
Ratio less than/equal to 28	349,813	74.6%
Ratio greater than 28, less than/equal to 33	89,775	19.1%
Ratio greater than 33	29,373	6.3%
Total (all loans)	**468,961**	**100.0%**

Source: GAO's analysis of HUD's data.

Federally Supported Programs to Promote Affordable Homeownership

Chapter 4 describes federal efforts to promote affordable homeownership, including federal programs and requirements placed upon the lenders and purchasers of mortgages. This appendix provides a detailed description of each of the federal programs included in chapter 4 with the exception of the FHA and VA programs, which are described in chapters 2 and 3. Generally, program data come from the National Council of State Housing Agencies, the Federal Housing Finance Board, HUD, VA, the Neighborhood Reinvestment Corporation, and the Rural Housing Service of the Department of Agriculture. We did not verify the accuracy and completeness of these data.

State Housing Finance Agencies

Central to the activities of the state housing finance agencies (HFA) are programs that promote homeownership. These programs rely upon federal incentives provided through mortgage revenue bonds (MRB) and mortgage credit certificates (MCC) and the Home Investment Partnership (HOME) program (described below). Specifically, under the federal mortgage revenue bond program, state HFAS raise funds by issuing tax-free mortgage revenue bonds. These funds are used to make loans to first-time home buyers. Funds may also be used as mortgage credit certificates issued to the home purchaser, which allows the purchaser to take a tax credit against a part of his or her home mortgage interest. The Tax Reform Act of 1986 restricted tax-exempt bond issues for housing. The act placed a cap for all private purpose tax-exempt bonds—of which MRBS are one—for each state. In 1994, every state as well as the District of Columbia, Puerto Rico, and the U.S. Virgin Islands had a housing finance agency.

Products Provided and Their Restrictions

HFAS offer first-time home buyers mortgages that may carry subsidized interest rates. The loans may be originated by a lender which then sells the loans to the HFA. Alternatively, first-time home buyers may receive a mortgage credit certificate, which provides the recipient with a nonrefundable federal income tax credit for a specified percentage of the annual interest paid on the mortgage of a principal residence. Homeowners may also receive loans for the purpose of rehabilitating a property or making home improvements.

The Congress has set limits on incomes and home purchase prices for home buyers under the mortgage revenue bond program. Home buyers may not have incomes that exceed 100 percent of the median family income for the area (115 percent for a family of three or more) and may not have owned a home in the last 3 years. The price of the property may

not exceed 90 percent of the average purchase price for homes in the area. Also, borrowers whose income rises more than 5 percent above the income limits are subject to pay the federal government up to half of any profit they make on the sale of the home within the first 9 years.

Assistance Provided and Characteristics of Homeowners

In 1994, the state housing finance agencies collectively used over $9 billion in MRB funds to make 89,288 home purchase loans and 3,531 rehabilitation and home improvement loans and to issue 11,701 mortgage credit certificates. Across HFAs, the mortgage amount for home purchases averaged $67,711.[1] Rehabilitation and home improvement loans were made in nine states and the District of Columbia and averaged $9,333. Across the 17 states that reported issuing mortgage credit certificates, the average mortgage amount associated with those receiving certificates was $61,127.

Of those assisted by HFAs through mortgages or mortgage credit certificates in 1994, the average income was about $30 thousand.[2] About 64 percent of homeowners assisted through mortgages or Mortgage Credit Certificates, and for which data were available, had incomes not exceeding 80 percent of the areas' median incomes.[3] Of the homeowners that received mortgages, 63.3 percent had incomes not exceeding 80 percent of the areas' median incomes. About 74 percent of the recipients of mortgage credit certificates had incomes no greater than 80 percent of the areas' median incomes. On average, 22 percent of borrowers were minorities in the District of Columbia and the 36 states that reported the race of borrowers under their MRB program and 30 percent in the 11 states that reported the race of borrowers under their MCC program. For the 39 HFAs that reported the location of properties financed with the proceeds of mortgage revenue bonds, 74 percent were in areas defined by the HFA as urban. For the 13 states reporting location data for recipients of mortgage credit certificates, 81 percent were in areas defined by the HFA as urban. For the 34 states reporting such data for their MRB program, an average of 16 percent of home purchasers were single-parent households. For the 12 states reporting such data for their MCC program, an average of 12 percent of recipients were single-parent households.

[1]Data are for the District of Columbia and all states except Arizona and Kansas.

[2]The data on the average income of homeowners assisted with mortgages are for the District of Columbia and all states, except Arizona, Kansas, and Nebraska. The data on the average income of homeowners receiving mortgage credit certificates are for 17 states.

[3]We excluded data for the state of Alabama's MCC and MRB programs and for the state of West Virginia's MCC program because the data on income distributions were incomplete.

Use of Mortgage Insurance

State housing finance agencies utilize mortgage insurance from both FHA and private mortgage insurers (PMI). In fact, nearly all the loans made by state housing finance agencies in 1994 were insured. For 1994, FHA insured over 55 percent of loans, VA over 8 percent, and PMIs insured about 20 percent. In addition, four states and seven HFAS insured mortgages, and eight HFAS utilized pool insurance. With the added protection of mortgage insurance, HFAS may offer more flexible terms than they might offer otherwise.

Federal Home Loan Banks' Community Investment Program

The Federal Home Loan Bank (FHLBank) System operates the Community Investment Program (CIP), which was authorized under section 721 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Specifically, each FHLBank, through its CIP program, provides discounted advances to lenders that are members of the FHLBank System. These lenders, in turn, use the funds for eligible loans. Federal Home Loan Banks reduce lending costs by providing advances priced at the FHLBS' cost of funds, plus reasonable administrative costs, resulting in a discount typically amounting to about one-quarter of 1 percent from the cost of regular advances. The discounted rate on the advance helps lenders to hold long-term, fixed-rate loans in their portfolios or to make loans they may not otherwise make. The Federal Housing Finance Board sets annual targets for the levels of new CIP advances.

Products Provided and Their Restrictions

CIP funds may be used for loans to finance home purchases and to rehabilitate housing, as well as for commercial and economic development activities that benefit low- and moderate-income families or activities that are located in low- and moderate-income neighborhoods. In connection with financing single-family homeownership, the subsidy provided to member institutions may or may not be passed on to the borrower, according to an FHFB official. When CIP advances are used for the purpose of financing the purchase of a home, the purchaser's income may not exceed 115 percent of the area's median income. According to a FHLB official, there are no other restrictions placed on the use of advances used to finance single-family homeownership. The standards for underwriting CIP loans are left up to the individual lenders.

Assistance Provided and Characteristics of Homeowners

In 1995, FHLBS made 632 advances for homeownership projects under the CIP program. Member institutions provided financing for 82,907 owner-occupied units. This financing—representing about $3.8 billion in

advances—was used for the purpose of home purchase and/or rehabilitation. According to an official, the Federal Housing Finance Board did not have data on the characteristics of the homeowners assisted through the CIP program. However, home purchasers assisted through the program may not have incomes greater than 115 percent of the area's median income.

Use of Mortgage Insurance

The Federal Housing Finance Board did not have data on the extent to which CIP loans have mortgage insurance. However, a program official noted that many FHLB member lenders do portfolio lending and that CIP is a tool that would allow these lenders to finance loans that they keep in portfolio. These lenders would then have the option of not requiring mortgage insurance.

Federal Home Loan Banks' Affordable Housing Program

The Federal Home Loan Banks also operate the Affordable Housing Program (AHP), through which the banks provide subsidies to members engaged in long-term lending for owner-occupied and rental housing targeted to households with very-low, low, or moderate incomes. Authorized by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Affordable Housing Program provides discounted advances (loans) to members that, in turn, lend the funds at reduced interest rates to specific AHP projects and make direct subsidies (grants) to members who pass the subsidies directly to specific projects or who use the subsidies to reduce the interest rate on loans that the members themselves provide to specific AHP projects. These subsidies are awarded on a competitive basis, and the program is administered by the Federal Housing Finance Board. AHP projects can be sponsored by public or private-sector organizations, with the AHP funding provided by the member institution that serves the area where the projects are located. The organization receiving AHP funding may receive subsidized interest on loans or a direct subsidy. More than 97 percent of the projects have a nonprofit or government sponsor. Funding for the AHP is derived from the FHLBank System's net earnings as determined by a statutory formula. AHP projects may also use funds from state HFAS, HOME, Home Ownership and Opportunity for People Everywhere, Community Development Block Grant, state and local government programs, and other grants and foundations.

Products Provided and Their Restrictions

Funds used for homeownership opportunities typically go to the homeowner in the form of a grant, according to an FHFB official. The funds

are used for down payment assistance and help with closing costs. Also, according to the Federal Housing Finance Board, AHP funds are often used in conjunction with other sources of funds, such as the FHLBank System's Community Investment Program and other federal, state, local, or private assistance programs. In our 1995 report on the program, we found that the AHP has helped member institutions expand their interest and experience in financing affordable housing while helping them meet their statutory requirements on community lending.[4] In September 1995, the Federal Housing Finance Board approved a program to set aside a limited portion of available AHP subsidies to assist first-time home buyers. The regulations authorize each bank to establish savings plans that would match household savings with AHP funds at a rate of 1 to 3, up to $5,000. This program includes requirements for counseling borrowers and a "soft" second mortgage.

Household income is restricted to 80 percent of the median income in the area where the funds are used to finance the purchase, construction, and/or rehabilitation of owner-occupied housing. According to an FHFB official, standards for underwriting are left up to individual lenders. However, the regulations for the AHP include language that encourages lenders to be flexible, but prudent. Also, projects are selected competitively; are oversubscribed by 3 to 1, according to a Finance Board official; and income targeting and long-term retention are criteria in the selection of projects. Finally, AHP funds are subject to recapture if, during the long-term retention period, the owner-occupied home assisted with AHP funds is sold to households that are not income-eligible for AHP assistance.

Assistance Provided and Characteristics of Homeowners

In 1995, FHLBS approved $48 million in AHP subsidies for owner-occupied units. These subsidies supported the purchase, construction, or rehabilitation of owner-occupied units for 10,241 households. For 1994, the average subsidy per unit was about $4,000. The income of homeowners who received subsidies from the AHP program may not exceed 80 percent of the area's median income. Indeed, the Finance Board reports that for 1994, about 70 percent of owner-occupied units that received AHP subsidies were owned by persons that had very-low income—less than 50 percent of the area's median income.

[4] Housing Finance: Improving the Federal Home Loan Bank System's Affordable Housing Program (GAO/RCED-95-82, June 9, 1995).

Use of Mortgage Insurance

According to an official, the Federal Housing Finance Board did not have data on the extent to which mortgage insurance is used in conjunction with projects that receive AHP subsidies.

Neighborhood Reinvestment Corporation/ NeighborWorks® Organizations

The Neighborhood Reinvestment Corporation (NRC) was created by the Housing and Community Development Act of 1978. The NRC promotes investment in communities by helping the formation of and providing technical assistance to local private and public-sector organizations—known as NeighborWorks® organizations (NWO)—and by providing grants to these organizations. In 1994, 173 NWOs were operating nationwide. NRC also is a primary source of funding for Neighborhood Housing Services of America, which purchases mortgages from NWOs. NRC is under the direction of a board of directors comprising the Secretary of HUD, a member of the Board of Governors of the Federal Reserve System, a Director of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and the Vice Chairman of the National Credit Union Administration. Although NRC is not a federal agency, about 91 percent of its $42.4 million fiscal year 1995 revenue came from federal appropriations. In fiscal year 1995, NRC provided about 50 percent of its appropriation as direct grants to NWOs, neighborhood preservation projects, and similar programs, in addition to technical services, training, program monitoring, and other direct services. NWOs work with lenders, insurers, and state and local governments. They also receive funding from HUD's CDBG, HOME, and HOPE programs. NWOs replenish second mortgage/rehabilitation loans by selling them to Neighborhood Housing Services of America.

Products Provided and Their Restrictions

NRC helps in the formation of local organizations that provide or channel investment in communities and is a primary source of funding for Neighborhood Housing Services of America, which purchases mortgages from NWOs. NWOs offer second-mortgages on properties and channel prospective home purchasers to lenders for first mortgages. In some instances, NWOs themselves will originate first mortgages. NWOs also offer homeowner education and counseling.

According to the NRC Executive Director, while NWOs are focused on low-income communities, there is no limitation on the income of individuals within those communities that may use NWOs' services. Underwriting standards are left up to the individual NWOs and the lenders with which they work. Whoever originates the loans sets the standards.

Because NWOs obtain funds from other sources, they may be limited in the terms of the products they offer by the standards established under other programs.

Assistance Provided and Characteristics of Homeowners

In fiscal year 1995, NeighborWorks® organizations were responsible for 2,854 second mortgages that were used by borrowers for rehabilitation—the NWOs originated about 90 percent of these mortgages. Lenders associated with the NWOs originated 4,330 first mortgages in fiscal year 1995. Historically, 54 percent of these first mortgages are on properties that also have second mortgages, according to the Executive Director of the NRC. Direct investment for single-family rehabilitation loans was about $37 million in fiscal year 1995. First mortgages for homeownership amounted to approximately $244 million in fiscal year 1995. While NWOs originated about 90 percent of the second mortgages reported, they typically do not originate first mortgages, according to an NRC official. With the advent of the Home Mortgage Disclosure Act and the Community Reinvestment Act, according to this official, there is a strong incentive for lenders to originate the first mortgage so that they get credit under the Community Reinvestment Act.

According to the data for new homeowners for the 36-month period ending December 31, 1995, 69 percent had household income of less than 80 percent of the area's median income. The median family income for home purchasers was $24,000. In addition, 61 percent of new homeowners were minorities, 97 percent were first-time home buyers, and 44 percent were female-headed households. In connection with the location of the home, NWOs are focused on low-income communities, according to the Executive Director of NRC.

Use of Mortgage Insurance

The use of mortgage insurance is not well known for the programs of NWOs. However, according to the Executive Director of NRC, some NWOs use FHA insurance extensively, while others avoid FHA. For example, one NWO is a direct endorsement lender of FHA-insured loans, according to the Executive Director. Also, a number of NWOs use FHA's Section 203(k) rehabilitation loans. Private mortgage insurance companies also provide insurance for first mortgages originated by the lenders associated with the NWOs.

Neighborhood Housing Services of America

Neighborhood Housing Services of America (NHSA) is a state-chartered, private, nonprofit organization established in 1974. It is funded by the Neighborhood Reinvestment Corporation as authorized by Congress in 1978. NHSA operates a secondary market for loans—primarily second mortgages—made by NWOs, thereby replenishing the loan funds of these organizations. NHSA also purchases first mortgages from NWOs. According to the Executive Director of the Neighborhood Reinvestment Corporation, as the grantor, NRC has responsibilities for overseeing NHSA. NHSA's Board of Directors is composed of private individuals. NRC is a primary source of funding for NHSA. Grants made by the NRC to NHSA totaled $4.5 million in fiscal year 1995. NHSA also receives funding from private-sector, institutional investors (including insurance companies, savings banks, and pension funds) through the sale of secondary market notes backed by loans purchased by NHSA.

Products Provided and Their Restrictions

NHSA provides liquidity to NWOs, which make second mortgages and arrange for lenders to make first mortgages on single-family properties. NHSA provides liquidity by purchasing loans that NWOs originate, thus permitting them to use the resulting funds for additional lending. NHSA then pools the mortgages it purchases and sells to social investors, through private placement, notes backed by these mortgages. In addition to these products related to single-family housing, NHSA also provides permanent financing for multi-unit or rental housing owned and managed by nonprofit organizations and short-term loans to NWOs to finance bridge loans for housing developed by nonprofits.

According to the NRC Executive Director, loans purchased by NHSA must be made for a property that is within the geographic area outlined in the map describing the area served by the NWO. Also, mortgages purchased by NHSA must be recorded, be fully amortizing, have at least quarterly principal and interest payments, and have fixed rates. Second mortgages must have full recourse, that is, the NWO agrees to substitute a new loan for any delinquent loan.

Assistance Provided and Characteristics of Homeowners

In fiscal year 1995, NHSA purchased 663 rehabilitation loans (second mortgages) and 470 first mortgages. These amounted to over $6.3 million in second mortgages on single-family homes and over $41 million in first mortgages on single-family homes. The median income of borrowers whose loans were purchased by NHSA was $22,800 for fiscal year 1995. Because NHSA purchases loans that are originated by NWOs, the

characteristics of the homeowners it assists are the same as the characteristics of borrowers assisted by NWOs. As described earlier, according to data for new homeowners served by NWOs for the 36-month period ending December 31, 1995, 69 percent had household incomes of less than 80 percent of the area's median income. In addition, 61 percent of the new homeowners were minorities, 97 percent were first-time home buyers, and 44 percent were female-headed households. In connection with the location of the home, NWOs are focused on low-income communities, according to the Executive Director of the NRC.

Use of Mortgage Insurance

In addition to any mortgage insurance on individual loans purchased by NHSA, PMI Mortgage Insurance Company provides pool insurance for first loans purchased from NHSA by the World Savings and Loan Association, according to the NRC Executive Director. The World Savings and Loan Association held $72.6 million in NHSA notes as of September 1995, of which $51.0 million was in notes backed by first mortgages.

Community Development Block Grant Program

The Community Development Block Grant program is authorized by title I of the Housing and Community Development Act of 1974. The purpose of the program, which is administered by the Department of Housing and Urban Development, is the development of viable urban communities by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. The program allocates grants to local governments and states on the basis of formulas that consider certain economic and demographic conditions. Grant recipients use CDBG funds for eligible community development activities of their choice. Among the activities that may receive CDBG funding are such housing activities as financing the purchase of housing, subsidizing mortgage payments, and paying a part of down payment and closing costs. In addition to housing activities, CDBG funds may be used for public works, public services, economic development, acquisition and clearance, and planning/administrative expenses.

Until recently, assistance to homeowners could be provided only by a subrecipient of the CDBG grantee. With the passage of the Cranston-Gonzalez National Affordable Housing Act of 1990, CDBG grantees were allowed for the first time to provide such homeowner assistance without the use of a subrecipient. However, at the close of fiscal year 1995, this authority had subsided and, without reauthorization, grantees must once again rely upon community based development

organizations—special subrecipients—to deliver this kind of housing assistance.

Grants to localities are made from annual appropriations. The fiscal year 1995 appropriation for the program was $4.8 billion. With the exception of small amounts used for special purpose grants, statutory set-asides, and Indian tribes, the appropriations are distributed on the basis of 70 percent to entitlement communities (cities and urban counties) and 30 percent to states for their nonentitlement communities (small cities). The largest share of CDBG expenditures by entitlement communities in fiscal year 1991—37 percent—went for housing-related activities.

Products Provided and Their Restrictions

Under the Cranston Gonzalez National Affordable Housing Act of 1990, CDBG grantees may provide direct assistance to facilitate and expand homeownership among persons of low and moderate income. Grantees may subsidize interest rates and mortgage principal amounts, finance the acquisition of housing that is occupied by the home buyer, acquire guaranties for mortgage financing obtained by home buyers from private lenders, provide up to 50 percent of any down payment, and pay reasonable closing costs incurred by the home buyer. If the local government uses a subrecipient, the above activities are eligible without the provisions of the Cranston Gonzalez National Affordable Housing Act.

Direct home buyer assistance is limited to home buyers of low and moderate income, that is, persons with incomes below 80 percent of the area's median income. Where housing assistance is provided by a special subrecipient, at least 50 percent of home buyers benefiting must be of low or moderate income. Also, regardless of the type of activity, at least 70 percent of all CDBG funds received by a grantee must be used for activities that benefit persons of low and moderate income.

Assistance Provided and Characteristics of Homeowners

Homeownership assistance accounted for $19.4 million of entitlement grantees' expenditures for program year 1992.[5] For the small cities programs administered by HUD and the states, housing activities—both single- and multifamily, including rehabilitation—totaled about

[5]The 1992 program year is set by the grantee itself. The year must begin no earlier than January 1, 1992, but no later than September 30, 1992, and end no later than September 30, 1993.

$250 million in fiscal year 1993.[6] Homeownership assistance includes (1) assistance that is provided by a special subrecipient, typically including cash transfer payments to the home buyer, and (2) direct assistance that may be provided by the grantee, including financing the acquisition of property, subsidizing interest rates and mortgage principal amounts, acquiring guaranties for mortgage financing from private lenders, providing up to 50 percent of down payments, and paying reasonable closing costs. For entitlement grantees, over 4,400 households received homeownership assistance through a special subrecipient during program year 1992, and almost 6,000 households received homeownership assistance from the grantee during that period.

Over 90 percent of the homeowners assisted by entitlement grantees during program year 1992 had incomes that were low or moderate—below 80 percent of the area's median income. Sixty-five percent were minorities, and 24 percent were female-headed households. Data were not available on the characteristics of homeowners assisted through the small-cities CDBG program.

Use of Mortgage Insurance

The extent to which housing assistance includes the use of mortgage insurance is not known.

Rural Housing Service

The Rural Housing Service of the Department of Agriculture administers a program that provides direct and guaranteed home loans to lower-income rural families. The loan program was first authorized in the Housing Act of 1949. The current Rural Housing Service was created with the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994. The program was established to provide housing credit for farm households because private credit sources were either nonexistent or inadequate in rural areas.

Today, the program provides loans to rural households that meet certain income and asset limitations and are unable otherwise to obtain mortgage credit at terms they can reasonably be expected to pay. The direct loans are made by any of the 1,700 county offices. Direct loans are subsidized by the Rural Housing Service. That is, interest credits are granted annually,

[6]All states except Hawaii and New York administer small-cities programs. The data reported on activities of the small-cities programs represent the reported distribution of funds to housing activities. According to a HUD official, housing activities include rehabilitation as well as homeownership activities for both single- and multifamily housing. Data were not available on the amount of assistance provided through the small-cities CDBG program that went toward single-family homeownership assistance only, or on the characteristics of those benefiting from homeownership assistance.

which would reduce the monthly installment on the note to an amount equal to what it would be if the note were amortized to as low as 1 percent, depending on the loan amount and the size and income of the family. The interest credit is subject to recapture by the government upon liquidation of the mortgage. Guaranteed loans are made by private lenders; the interest rate is negotiated with the lender. In guaranteeing a single-family housing loan, the Rural Housing Service agrees, in the event that a borrower defaults, to reimburse a commercial lender for up to 90 percent of lost principal plus accrued interest and liquidation costs.

As of December 31, 1995, the outstanding principal balance on the 696,665 direct single-family housing loans held by the Rural Housing Service was $18 billion. In addition, the Rural Housing Service had guaranties on 39,241 loans, with an outstanding principal of $2.4 billion. To cover the interest subsidy on direct loans and expected losses from guaranteed loans, the estimated subsidy for fiscal year 1995 was $245 million. Lenders that are approved issuers of mortgage-backed securities guaranteed by the Government National Mortgage Corporation may use Rural Housing Service-guaranteed loans to back securities guaranteed by Ginnie Mae.

Products Provided and Their Restrictions

The Rural Housing Service provides direct loans to rural borrowers and loan guaranties to lenders that provide loans to rural borrowers. The direct loans carry an interest subsidy that could reduce the interest rate to the borrower to as low as 1 percent. The interest subsidy is subject to recapture by the government upon liquidation of the loan. Direct loans may be made to eligible applicants to buy, build, repair, renovate, or relocate homes and provide related facilities, or to refinance home debts, under certain conditions, when necessary to help a family retain ownership of its home. Funds may also be used to improve water and waste disposal systems. Guaranteed loans may be made by lenders for the purpose of a borrower's acquiring or constructing a home.

The Rural Housing Service's loan program is generally limited to rural areas, which include communities with populations of less than 10,000 in metropolitan statistical areas (MSA) and communities with populations between 10,000 and 20,000 in non-MSAs.[7] To be eligible for a subsidized direct loan, borrowers generally may not have income in excess of 80 percent of the area's median income. Borrowers under the guaranteed

[7]Loans may also be made in areas with a population in excess of 10,000 but less than 20,000 if (1) the area is not included in an MSA and (2) the Secretaries of Agriculture and Housing and Urban Development determine that the location has a serious lack of mortgage credit for low- and moderate-income borrowers.

loan program may have moderate income—no more than 115 percent of an area's median income. Borrowers may obtain loans for up to 100 percent of the value of the property. The maximum mortgage amount under the direct and guaranteed loan programs is $78,660, except in designated high-cost areas. As with FHA loans, the maximum amount of Rural Housing Service loans in designated high-cost areas may be as high as $155,250. Borrowers must be unable to secure the necessary credit from other sources at prevailing terms and conditions for residential-type financing; be a citizen; have adequate and dependable available income to meet family living expenses, including taxes, insurance and maintenance, and repayments on debts, including the proposed loan.

Assistance Provided and Characteristics of Homeowners

In fiscal year 1995, the Rural Housing Service made 15,405 single-family loans totaling $934 million. All direct loans carry an interest subsidy. In addition, the Rural Housing Service guaranteed 16,677 loans, totaling over $1 billion. Direct loans were made in every state, with the greatest activity in California, North Carolina, Ohio, Pennsylvania, and Texas. The Rural Housing Service also guaranteed loans in every state, with the greatest activity in California, Florida, Georgia, Michigan, and North Carolina. To meet program requirements, all borrowers receiving direct loans from the Rural Housing Service must have incomes that are no greater than 80 percent of the area's median income. About 27 percent of the guaranteed loans made in fiscal year 1995 went to borrowers who had incomes no greater than 80 percent of the area's median income.

Use of Mortgage Insurance

The guaranty that the Rural Housing Service provides lenders functions like mortgage insurance. Under its loan guaranty program, the Rural Housing Service will pay a lender up to 90 percent of the lost principal plus accrued interest and liquidation costs in the event a borrower defaults on a guaranteed loan. In comparison, FHA insurance provides lenders with 100 percent coverage of their losses; private mortgage insurers provide far less coverage. For its direct loan program, because the Rural Housing Service holds these loans—which have interest subsidies—there is no mortgage insurance. However, any losses resulting from a borrower's defaulting on a direct loan are borne entirely by the federal government.

Home Investment Partnerships Program (HOME)

The HOME program, administered by HUD, provides funds to participating state and local governments for the development and support of affordable rental housing and homeownership opportunities for low-income families. The program was enacted by the Congress in the

National Affordable Housing Act of 1990. Using a formula based on the extent of local housing needs, HUD distributes HOME funds to participating jurisdictions.[8] A participating jurisdiction may use its HOME funds for a variety of eligible activities, provided they are designated in the affordable housing strategy that the program requires each jurisdiction to prepare. Each jurisdiction must set aside at least 15 percent of its HOME allocation for use by qualified, nonprofit community housing development organizations. These organizations use the funds to own, sponsor, or develop housing.

Products Provided and Their Restrictions

Participating jurisdictions are given the flexibility to use HOME funds in a variety of ways to promote homeownership, depending on local needs. They may use HOME funds for equity investments, interest-bearing and non-interest-bearing loans, interest subsidies, deferred payment loans, grants, or in some other way. According to the program director at HUD, HOME funds for homeownership are typically used in the form of a second mortgage. Despite the flexibility permitted by the HOME program, several restrictions govern how participating jurisdictions may use funds for homeownership. First, all HOME funds used for homeownership assistance must be targeted at families whose incomes do not exceed 80 percent of the area's median income. In addition, homes may not have an initial purchase price higher than 95 percent of the area's median purchase price and must be the principal residence of the assisted family.

Owner-occupied homes for which HOME assistance was provided are also subject to federally established resale and recapture provisions. During a designated recapture period, these homes must be resold to other low-income families unless the participating jurisdiction recaptures the full HOME investment from the net proceeds of the sale. The recapture period is 5 years for homes in which less than $15,000 in HOME funds was provided, 10 years for homes in which $15,000 to $40,000 in HOME funds was provided, and 15 years for homes in which more than $40,000 in HOME funds was provided.

Assistance Provided and Characteristics of Homeowners

During fiscal year 1995, participating jurisdictions spent $237.9 million in HOME funds on homeownership activities. These funds were used to help 18,898 households. Total budget outlays for fiscal year 1995 were an estimated $1.2 billion.

[8]Before applying the needs formula, some HOME funds are set aside for Native Americans, insular areas, and technical assistance. Also, of the funds allocated by formula, 60 percent are available for metropolitan cities, urban counties and consortia and 40 percent for states.

All households that receive homeownership assistance through the HOME program are required to have incomes no greater than 80 percent of the area's median income. According to HUD data, of all homeowners assisted during fiscal year 1995, 8.4 percent had incomes no greater than 30 percent of the area's median, 23.6 percent had incomes of 31 to 50 percent of the area's median, and 68.0 percent had incomes of 51 to 80 percent of the area's median. Half of the homeowners assisted during fiscal year 1995 were minorities.

Before 1994, regulations required that all HOME funds used for homeownership assistance go to first-time home buyers. However, concern over the slow expenditure of HOME funds prompted several program changes, including the elimination of this requirement. As of August 1994, repeat home buyers also became eligible for HOME assistance.

Use of Mortgage Insurance

According to the program director at HUD, FHA mortgage insurance is sometimes used in conjunction with HOME funds to assist low- and moderate-income homeowners. However, these cases are subject to additional program resale provisions. For 30 years after HOME funds are provided, an owner-occupied home with an FHA insured mortgage may be resold only to other low-income households. According to a program official, HUD has issued many waivers to this affordability period. There was no information available on the extent to which HOME activities employ mortgage insurance.

Homeownership and Opportunity for People Everywhere, for Homeownership of Single-Family Homes

Among three Homeownership and Opportunity for People Everywhere (HOPE) programs, the Homeownership of Single-Family Homes program which helps low-income families purchase single-family properties owned by federal, state, and local governments. The HOPE 3 program was created by the Cranston-Gonzalez National Affordable Housing Act of 1990. The program provides grants to private nonprofit organizations, cooperative associations, or a public body in cooperation with a private nonprofit organization. These grants may be used for planning and implementing homeownership programs designed to meet the needs of low-income, first-time home buyers. Planning grants help applicants develop homeownership programs, and implementation grants enable applicants to carry out homeownership programs. Homeownership programs allow eligible families to acquire single-family properties owned or held by HUD, the Department of Veterans Affairs, the Department of Agriculture, the Resolution Trust Corporation (RTC), a state or local government, or a

public housing authority. The program is overseen by HUD and carried out by private nonprofits or by public agencies in cooperation with private nonprofits. The criteria for awarding planning grants are the capability of the applicant, the extent of public/private support, the need for the homeownership program, and the soundness of the planning approach. The criteria for awarding implementation grants are the capability of the applicant, the extent of public/private support, the quality of the program's design, the cost-effectiveness in using federal grant funds, the extent to which the applicant is committed to promoting the use of minority- and women-owned businesses, the extent to which the program uses federal properties, and the degree to which the applicant furthers fair housing choice. The fiscal year 1995 appropriation for HOPE 3 was $20 million—all for implementation grants. In addition, each grant recipient must ensure that contributions equal to not less than 25 percent of the implementation grant amounts are provided from nonfederal sources.[9]

Products Provided and Their Restrictions

HUD provides grant funds to nonprofits that then use these funds to help eligible families acquire and rehabilitate homes owned or held by HUD, VA, Agriculture, RTC, state or local governments, or a PHA. To make the property affordable to the home buyer, grantees may offer interest rate reductions, payment of all or a portion of closing costs, down payments, mortgage insurance premiums, and other expenses. Grantees may also use funds to pay for architectural and engineering work, relocation of residents in eligible properties who elect to move, temporary relocation of resident home buyers during rehabilitation, legal fees, reasonable marketing costs, counseling and training of home buyers, property management and holding costs, grantee training, economic development directly related to the homeownership program, and administrative costs. Mortgages provided home buyers that are not fully amortizing may not be used.

To be eligible for homeownership assistance, a family or individual must have an income that does not exceed 80 percent of the area's median income and must be a first-time home buyer. The cost of acquiring and rehabilitating a property is limited to 80 percent of the FHA mortgage limit for the area, plus reasonable and customary closing costs. The monthly expenditure for principal, interest, taxes, and insurance must be not less than 20 percent and not more than 30 percent of the adjusted income of the family (closing costs included, if financed). Each eligible family

[9]Nonfederal resources may include assistance that an applicant receives from the Federal Housing Finance Board under its affordable housing program, so long as the AHP application is approved by the Finance Board within 30 days of HUD's conditional approval of the HOPE 3 application.

selected must certify that it intends to occupy the units as its principal residence during the 6-year period from the date it acquires ownership.

Restrictions on resale include a limit on the equity the homeowner may retain, a requirement for the homeowner to execute a nonamortizing, nonrecourse, non-interest-bearing promissory note for the difference between the purchase price and fair market value of the property, and a prior right of the cooperative or PHA to purchase the property under certain circumstances. The promissory note is forgiven over time and is completely forgiven at the end of a 20-year period. Each eligible family selected for the program must participate in counseling and training of home buyers and homeowners on the general rights and responsibilities of homeownership.

Assistance Provided and Characteristics of Homeowners

In 1995, HUD awarded 45 HOPE 3 implementation grants totaling $23 million. From part of these and previous grants, grantees funded programs that allowed 1,396 families to become homeowners. Most properties sold under the HOPE 3 program are planned to come from FHA.[10] A May 1995 report prepared for HUD found that, according to the plans of the grantees, 52 percent of the properties to be sold would come from FHA. The next greatest expected source of properties was local governments, with 22 percent of properties. The remaining properties were planned to come from VA, RTC, RHS, PHAs, and state governments. The May 1995 report found that nearly all of the units sold through the HOPE 3 program require some level of rehabilitation. According to this study,

> "20 percent of all grantees engage in minor rehab at a cost of less than $10,000 per unit. On the other hand, half (51 percent) undertake moderate rehab costing between $10,000 and $30,000 per unit, and 29 percent engage in extensive rehab in a typical unit at a cost of more than $30,000."[11]

In connection with the type of financial assistance that homeowners received, the study surveyed all grantees during January and February 1994 and found that the most common forms of assistance were closing cost assistance (86 percent of grantees reporting), down payment assistance (79 percent), below-market interest rate (61 percent), reduction

[10]With the exception of the period from November 1993 through September 1994, HOPE 3 grantees have since November 1992 been allowed to bid on FHA properties along with other prospective "owner occupants" in advance of their being offered to the general public. In addition, if a HOPE 3 grantee wins the bid, he or she receives a 10-percent discount off the winning price.

[11]Evaluation of the Hope 3 Program, prepared for HUD's Office of Policy Development and Research by Abt Associates, Inc., May 1995.

in sales price (48 percent), deferred loan payment (39 percent), sweat equity (22 percent), and other grants (19 percent). In connection with loan sources, 64 percent of grantees reported that they planned to use conventional loans, 50 percent reported that they planned to use HOPE 3 direct loans, 28 percent reported that they planned to use FHA, VA, and RHS loans, 21 percent reported that they planned to use loans from state HFAS, and 17 percent planned to use loans from the local government. Finally, each eligible family selected for the program is required to participate in counseling and training on the general rights and responsibilities of homeownership.

The HUD program office did not have data on the characteristics of persons who became homeowners through the HOPE 3 program. However, to be eligible for assistance under the HOPE 3 program, a family must have an income that does not exceed 80 percent of the area's median income and must be a first-time home buyer. The May 1995 study found that according to information on the 211 households that had purchased properties as of May 1994, 35 percent had incomes below 50 percent of the area's median income, 62 percent were minorities, and nearly half were single-parent families.

Use of Mortgage Insurance

FHA-insured loans represented about 19 percent of home buyer financings under the HOPE 3 program. Twelve percent of financings were loans insured under FHA's Section 203(b) program, and about 2 percent were loans insured under FHA's Section 203(k) rehabilitation mortgage program or other programs. About 48 percent of all financings were conventional mortgages. Whether those who financed their home purchase with a conventional loan had private mortgage insurance is not known. If a mortgage is insured by FHA, the requirements of FHA apply with certain exceptions: the borrower may obtain a loan for the down payment from a corporation or another person; a second mortgage may be placed against the property by an entity that is not a federal, state, or local government agency; and certain other restrictions on conveyances exist.

Comments From the Mortgage Insurance Companies of America

Mortgage Insurance Companies of America

Suzanne C. Hutchinson
Executive Vice President

June 12, 1996

Mr. Robert Procaccini
Assistant Director
Housing and Community Development
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Procaccini:

MICA appreciates the opportunity to comment on the GAO study of FHA's Role in Helping People Obtain Home Mortgages. We were pleased to learn that several of the factual problems the draft report contained have been remedied. We would like to make the following points regarding the study:

- The report implies that the FHA single-family program presents no risk of taxpayer loss. It does not explain that FHA is backed by the full faith and credit of the U.S. government, and if the program became insolvent, it would have access to the U.S. Treasury. Prior to the 1990 legislation that reformed FHA, it was losing almost $1 million a day. The 1990 reforms were enacted to minimize the likelihood of a Federal bailout occurring.
- The report compares FHA and private mortgage insurance loan data without adjusting for differences between them. First, FHA and private mortgage insurers calculate LTV ratios differently. The private mortgage insurance calculation divides the total mortgage amount by the property value, which is not the same as the FHA calculation as reported in FHA publications. In addition, the LTV data for privately insured loans used in the report is from a sampling of Federal Home Loan Bank member institutions, while it appears that the FHA data is complete and not a data sample.
- The report understates the number of FHA borrowers who would qualify for a privately insured loan. The report states that 34 percent of 1995 FHA home purchase loans would

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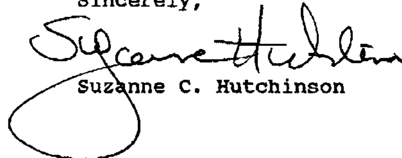
meet private mortgage insurance guidelines for all three of the ratios considered -- LTV, total debt-to-income and housing debt-to-income. The report assumes that if an FHA borrower met only one or two of the ratios, he would not qualify for a privately insured loan. That is not necessarily the case. The competitive nature of the private mortgage insurance industry and the flexibility of its underwriting criteria -- as opposed to FHA's uniform criteria -- mean that compensating factors may enable a borrower to qualify for a privately insured loan even if he does not meet all three ratios.

- Finally, the report understates the important role Fannie Mae and Freddie Mac play in the conventional mortgage market. The report compares the underwriting guidelines of mortgage insurers and FHA, but fails to include in that comparison Fannie Mae's and Freddie Mac's criteria for purchasing loans.

Thank you for the opportunity to share our comments with you.

Sincerely,



Suzanne C. Hutchinson

Comments From the National Council of State Housing Agencies

May 29, 1996

Ms. Judy A. England-Joseph, Director
Housing and Community Development Issues
United States General Accounting Office
Washington, DC 20548

Dear Ms. England-Joseph:

The National Council of State Housing Agencies (NCSHA) appreciates this opportunity to comment on excerpts of the draft General Accounting Office (GAO) report to Chairman Lazio's Subcommittee on Housing and Community Opportunity entitled *Homeownership: FHA's Role in Helping People Obtain Home Mortgages.*

NCSHA is a national, nonprofit organization created in 1970 to assist its members in advancing the interests of lower income and underserved people through the financing, development, and preservation of affordable housing. NCSHA's members are Housing Finance Agencies (HFAs) with statewide authority. NCSHA's members operate in every state and the District of Columbia, Puerto Rico, and the United States Virgin Islands.

At the center of HFA activities within the states and NCSHA's work in Washington are three federally authorized programs: tax-exempt Mortgage Revenue Bonds (MRBs) and multifamily housing bonds; the Low Income Housing Tax Credit (Housing Credit); and the HOME Investment Partnerships (HOME) program. NCSHA is the principal advocate for MRBs, multifamily housing bonds, and the Housing Credit, and the principal state advocate for the HOME program.

Using these tools, HFAs have crafted hundreds of housing programs—from homeownership to rental to all types of special needs housing. Many HFAs also administer other state and federal housing assistance programs.

We commend you for clearly demonstrating and documenting the vital importance of FHA single family insurance to low income, minority, and first-time homebuyers—the very people HFAs serve, often with the help of FHA insurance. As the report notes, 55 percent of state MRB loans were FHA-insured in 1994. That percentage increases to over 62 percent if one discounts the six HFAs which either self-insure or provide state insurance for a significant portion of their MRB loans.

444 North Capitol Street, NW, Suite 438 Washington, DC 20001 (202)624-7710 FAX (202)624-5899

Ten years ago, only ten HFAs relied on FHA to insure 60 percent or more of their MRB loans. Today, 28 HFAs insure 60 percent or more of their MRB loans with FHA single family insurance. Five more count on FHA for more than half their coverage.

Low income, minority, and first-time homebuyers underserved by the private mortgage insurers (PMIs) rely on FHA insurance to make possible the American dream of homeownership. While PMIs now serve these people more reliably in more parts of the country than in the past, they do so only where they can make a profit. FHA's unique role is as a counter cyclical force providing stability during economic downturns which force the PMIs out of difficult regional markets.

Where and when the PMIs have been willing to serve lower income homebuyers, HFAs often have been their partner; your report notes that 20 percent of state HFA loans were privately insured in 1994. But the report also notes that nearly two-thirds of FHA-insured loans in 1994 "would probably not have qualified for private mortgage insurance." FHA single family insurance, often in conjunction with state HFA programs, serves the low income working families behind that statistic.

We do not dispute the report's finding that other government homeownership assistance programs generally provide a higher percentage of their assistance to low income, minority, and first-time homebuyers. We are concerned, however, that this finding may be misinterpreted or misrepresented by those who would target FHA insurance exclusively to members of those groups.

To avoid this potentially damaging outcome, we encourage you to point out in the final report that FHA insures a certain number of middle-income borrowers with lower, less risky loan-to-value (LTV) ratios so it can balance the risk of the higher LTV low income family and first-time homebuyer loans in its portfolio. Targeting FHA single family insurance to the most needy, as some have suggested, would require a higher premium which many borrowers currently served would be unable to pay, or a subsidy which Congress would be unwilling to fund.

As you know, FHA single family insurance has never cost the taxpayers money in its more than 60 years in existence. The program is a totally self-sustaining insurance fund which operates more like a private business than a typical government subsidy program.

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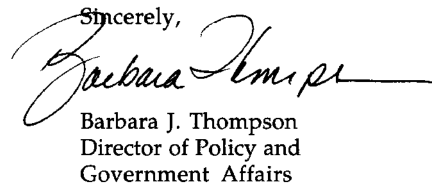
The report also notes that over half of the ten government homeownership programs it compares to FHA single family insurance require appropriations of federal funds, while the FHA program does not. We encourage you to mention in the final report that FHA single family insurance actually makes money for the federal government, cutting the federal deficit. The Mortgage Bankers Association estimates that FHA made $300 - $500 million in 1994. Assuming that rate of growth, FHA will contribute over $2 billion to deficit reduction by the year 2000.

Furthermore, FHA's financial soundness continues to improve. Another recent GAO report, *FHA Mortgage Financing*, found that the single family insurance program's Mutual Mortgage Insurance Fund's economic net worth of $6.1 billion represents a capital reserve ratio in excess of the congressionally mandated target for the year 2000.

We hope you will consider these comments in finalizing the report. Please contact me if I can be of any further assistance.

Sincerely,



Barbara J. Thompson
Director of Policy and
Government Affairs

3

Comments From the Federal Housing Finance Board

Federal Housing Finance Board
1777 F Street, N.W., Washington, D.C. 20006
Telephone: (202) 408-2500 Facsimile: (202) 408-1435

June 17, 1996

Ms. Judy A. England-Joseph
Director
Housing and Community
Development Issues
United States General Accounting Office
Washington, DC 20548

Dear Ms. England-Joseph:

The Federal Housing Finance Board (Finance Board) appreciates the opportunity to review and comment on the General Accounting Office's draft report entitled Homeownership: FHA's Role in Helping People Obtain Home Mortgages. We have reviewed the report sections which address Federal Home Loan Bank (FHLBank) System activities. While we generally agree with the information provided, the following comments are provided to correct or clarify several issues in the draft report. Specifically:

Now on p. 7.

Page 9 - Under the heading Other Federal Activities Promote Affordable Homeownership but Reach Fewer Households Than FHA, the statement concerning the FHLBanks' Affordable Housing Programs (AHP) and Community and Investment Programs (CIP) should be revised to state that those programs "provide subsidies or subsidized or otherwise below-market rate advances".

Now on p. 63.

Page 73 - The report identifies special requirements the federal government imposes on certain lenders for meeting housing finance needs. It might be appropriate to add the Community Support Program (CSP) that requires FHLBank members to meet standards of community investment or service in order to maintain continued access to long-term FHLBank System advances. Each member is required to submit, for Finance Board review, the public disclosure portion of its most recent Community Reinvestment Act (CRA) evaluation and a description of how the member assists first-time homebuyers.

Now on p. 64.

Page 75 - The first full sentence concerning the FHLBank System's AHP and CIP should be revised to state that those programs "provide subsidies and subsidized or otherwise below-market rate advances".

Now on p. 66.

Page 77 - The chart should include a check for the FHLBanks' AHP in the column "Recapture of benefits". AHP awards provided to owner-occupants are subject to recapture if the AHP assisted unit is sold to an income-ineligible household prior to the expiration of the long-term retention period applicable to the unit.

Now on p. 67.

Page 78, second sentence, last paragraph - The referenced connection between FHLBank advances and deposit insurance appears to be a non sequitur. No "government funds" are involved in making FHLBank advances; all FHLBank advances are required by statute to be fully secured; no FHLBank has ever suffered losses on its advances; in the event of a receivership of the borrowing member institution, the FHLBank is by statute a preferred creditor. While it is true that the federal government experienced losses in the S&L bailout through deposit insurance payouts and otherwise, there is no connection between those losses and FHLBank AHP and CIP advances.

Now on p. 68.

Page 79 - The report includes 1994 data for some programs and 1995 data for other programs. Where possible, we have provided 1994 and 1995 data which is missing from the draft report. The specific data provided is found in our following comments on each report page. For example, 18 housing finance agencies (HFAs) were approved as non-member mortgages by the end of 1994 and a total of 23 HFAs were approved by the end of 1995.

Now on p. 71.

Page 83 - In calendar year 1994, $34.2 million in AHP funding was approved for 8,426 homeowner households. In calendar year 1995, $48 million was approved for 10,241 households. In addition, the chart on this page identifies two separate footnotes with the letter "d".

Now on p. 91.

Page 111 - Under the heading Federal Home Loan Banks' Community Investment Program, the description is imprecise. The statute requires each FHLBank to "establish a program to provide funding for members to undertake community oriented mortgage lending". Therefore, there is not one universal community investment program; each FHLBank has established its own CIP.

Now on p. 91.

Pages 111 and 112 - Under the heading Products Provided and Their Restrictions, the description of the uses of the CIP is not entirely accurate. The uses of the CIP are outlined in the statute. Community oriented mortgage lending is defined in the statute as providing loans (1) to finance home purchases by families whose income do not exceed 115% of the area median income; (2) to finance purchase or rehabilitation of housing for occupancy by families whose incomes do not exceed 115% of the area median income; (3) to finance commercial and economic development activities that benefit low and moderate income families or activities that are located in low and moderate income neighborhoods; and (4) to finance projects that further a combination of purposes (1) through (3). Therefore, the statement that other than the 115% requirement, there are no other restrictions placed on the use of CIP advances, is not correct.

Now on p. 91.

Page 112 - In calendar year 1994, the FHLBanks made 526 CIP advances totaling $2.08 billion for 43,439 owner-occupied units. In calendar year 1995, the FHLBanks made 632 CIP advances totaling $3.8 billion for 82,907 owner-occupied units.

2

Now on p. 93.

Page 114, last sentence, second paragraph - Clarify this to indicate that "income-targeting" and "long-term retention" are criteria used in the competitive selection of AHP funded projects. AHP funds are subject to recapture if, during the long-term retention period, the owner-occupied home assisted with AHP funds is sold to households that are not income-eligible for AHP assistance. Projects serving the greatest percentage of very low income households and with the longest retention periods receive more points in the scoring system. As of the end of 1995, the average long-term retention period for owner-occupied units was 24 years.

Again, we appreciate the opportunity to provide written comments on your draft report.

Sincerely,

Rita I. Fair
Managing Director

3

Comments From the Neighborhood Reinvestment Corporation

Neighborhood Reinvestment Corporation

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Tel 202.376.2400
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May 24, 1996

Judy A. England-Joseph
Director, Housing and Community Development Issues
Resources, Community, and Economic Development Division
United States General Accounting Office
Washington, DC 20548

Subject: **Comments on Draft Report -**
HOMEOWNERSHIP:
FHA's Role in Helping People Obtain Home Mortgages

Dear Ms. England-Joseph

Thank you for providing me with an opportunity to review a draft of GAO's report entitled Homeownership: FHA's Role in Helping People Obtain Home Mortgages.

I focused my review on the portions of the report which discuss the activities of the Neighborhood Reinvestment Corporation, and although you have captured the essence of our homeownership-related activities well, I do have a few clarifying comments. I have also included information which you may chose to use to update the Neighborhood Reinvestment and NHSA data, from fiscal year 1994 to fiscal year 1995:

Now on p. 64.

On page 75. (and throughout the Report): Please change Neighborworks to NeighborWorks® (one word, with capital W, and registered service mark).

Now on p. 66.

On page 77. The reference within Table 4.1 to "NRC's NWOs" should also include "Down payment closing help".

Now on p. 69.

On page 80. The reference within Table 4.2 to "NRC's NWOs" "Other sources of funds" should also include: private sector contributions and NHSA (in addition to the current comment about selling loans to NHSA).

Also: "Other sources of funds" for NHSA, should also include private sector contributions.

Now on p. 70.

On page 81. **Update:** . . . and 69 percent of new homeowners assisted by Neighborhood Reinvestment Corporation programs had low incomes.

(Note that this refers to **new** homeowners. A much higher percentage of low-income homeowners were assisted with rehab loans and other services).

Now on p. 71.
Now on p. 71.

Page 82. **Update:** The NRC reported that 97 percent of the homeowners . . .

page 83. **Update:** While the data indicated on Table 4.3 for NRC's NWOs is correct for FY 94, it can be updated to FY 1995 as follows:

Number of homeowners assisted:	7,184 [a,d]
Amount of loan or assistance provided:	$295.1 million
Low income:	69 percent
Minority:	61 percent
First time buyer:	97 percent
Year:	FY 95[e]

Footnote[d]: Includes 2,854 rehabilitation loans and 4,330 first mortgages. Over half of the first mortgages would also have a rehabilitation loan (averaging between $7,000 to $8,000).

Footnote[e]: Data on homeowners' characteristics are for the 36 month period ending December 1995.

Now on p. 72.

Page 84. After the phrase: "The use of mortgage insurance on individual loans made by NWOs was not known," add:

but both GE Capital Mortgage Corporation and Mortgage Guaranty Insurance Corporation provide mortgage insurance on special loan products offered through the NeighborWorks® Campaign for Home Ownership that allow for higher loan-to-value ratios.

(Then, drop "However" and insert Further, -- and continue with "the PMI . . .)

Now on p. 94.

Page 115 Appendix II. In both the sub-title and the text, please use: NeighborWorks® (one word, with capital W, and registered service mark).

Revise: "NRC also is the principal source of funding . . ." by striking "the principal" and inserting "a primary".

Update: . . . about 91.4 percent of its $42.4 million fiscal year revenue came from federal appropriations. In fiscal year 1995, NRC provided about 50.4 percent of its appropriation as direct grants to NWOs, neighborhood preservation projects and similar programs, . . .

Add to above: . . . in addition to technical services, training, program monitoring and other direct services.

Now on p. 95.

Page 116. **Revise:** ". . . and is the principal source of funding . . ." by striking "the principal" and inserting "a primary".

Update: Information below the Assistance Provided . . . subheading as follows:

In fiscal year 1995, NeighborWorks® organizations were responsible for 2,854 second mortgages . . . .

Lenders associated with the NWOs originated 4,330 first mortgages in fiscal year 1995.

Direct investment for single-family rehabilitation loans was about $36.5 million in fiscal year 1995.

Now on p. 95.

on to Page 117: First mortgages for homeownership amounted to approximately $244 million in fiscal year 1995

Based on data for new homeowners for the 36-month period ending December 31, 1995, 69 percent had household income of less than 80 percent of the area's median income. The median family income for home purchasers was $24,000. In addition, 61 percent of new homeowners were minorities, 97 percent were first-time home buyers, and 44 percent were female-headed households.

Now on p. 96.

Page 118. **Revise:** "NRC is the principal source of funding . . ." by striking "the principal" and inserting "a primary".

Update: Grants made by the NRC to NHSA totaled $4.5 million in fiscal year 1995.

Now on p. 97.

Page 119. **Update:** . . . for the 36-month period ending December 31, 1995, 69 percent had household income of less than 80 percent of the area's median income. The median family income for home purchasers was $24,000. In addition, 61 percent of new homeowners were minorities, 97 percent were first-time home buyers, and 44 percent were female-headed households.

I trust these comment are clear and helpful, but please contact me if I can provide any further information or clarification.

Sincerely,

for George Knight
Executive Director

Major Contributors to This Report

Resources, Community, and Economic Development Division

Leslie Black-Plumeau
DuEwa Kamara
Cheryl Kramer
Donna Lucas
Robert Procaccini
Mathew Scire
Patrick Valentine

Related GAO Products

Mortgage Financing: FHA Has Achieved Its Home Mortgage Capital Reserve Target (GAO/RCED-96-50, Apr. 12, 1996).

Government Corporations: Profiles of Existing Government Corporations (GAO/GGD-96-14, Dec. 13, 1995).

Community Reinvestment Act: Challenges Remain to Successfully Implement CRA (GAO/GGD-96-23, Nov. 28, 1995).

Rural Housing: Opportunities Exist for Cost Savings and Management Improvement (GAO/RCED-96-11, Nov. 16, 1995).

Property Disposition: Information on HUD's Acquisition and Disposition of Single-Family Properties (GAO/RCED-95-144FS, July 24, 1995).

Housing Finance: Improving the Federal Home Loan Bank System's Affordable Housing Program (GAO/RCED-95-82, June 9, 1995).

Community Reinvestment Act: Preliminary Results of GAO's Study on CRA Problems and Proposed Reforms (GAO/T-GGD-95-113, Mar. 8, 1995).

Rural Housing: Shift to Guaranteed Program Can Benefit Borrowers and Reduce Government's Exposure (GAO/RCED/AIMD-95-63, Dec. 21, 1994).

Housing Finance: Implications of Alternative Methods of Adjusting the Conforming Loan Limit (GAO/RCED-95-6, Oct. 5, 1994).

Tax Policy: Tax Expenditures Deserve More Scrutiny (GAO/GGD/AIMD-94-122, June 3, 1994).

Housing Finance: Characteristics of Borrowers of FHA-Insured Mortgages (GAO/RCED-94-135BR, Apr. 6, 1994).

Government National Mortgage Association: Greater Staffing Flexibility Needed to Improve Management (GAO/RCED-93-100, June 30, 1993).

Community Development: Neighborhood Reinvestment Corporation Should Improve Program Management (GAO/RCED-92-174, July 8, 1992).

Federal Agricultural Mortgage Corporation: Potential Role in the Delivery of Credit for Rural Housing (GAO/RCED-91-180, Aug. 7, 1991).

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