



Highlights of [GAO-05-194](#), a report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

### Why GAO Did This Study

The U.S. Department of Housing and Urban Development (HUD), through its Federal Housing Administration (FHA), insures billions of dollars in home mortgage loans made by private lenders. FHA insures low down payment loans and a number of parties have made proposals to either eliminate or otherwise change FHA's borrower contribution requirements. GAO was asked to (1) identify the key characteristics of existing low and no down payment products, (2) review relevant literature on the importance of loan-to-value (LTV) ratios and credit scores to loan performance, (3) report on the performance of low and no down payment mortgages supported by FHA and others, and (4) identify lessons for FHA from others in terms of designing and implementing low and no down payment products.

### What GAO Recommends

GAO suggests that Congress consider limiting any new no down payment product it may authorize. GAO recommends that HUD, among other things, consider piloting new or changed products and that HUD establish a framework for when and how to pilot products. In written comments, HUD stated that it had considered these actions, including piloting, but instead adopted an alternative solution. However, it is not clear under which circumstances HUD would consider piloting.

[www.gao.gov/cgi-bin/getrpt?GAO-05-194](http://www.gao.gov/cgi-bin/getrpt?GAO-05-194).

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

## MORTGAGE FINANCING

# Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products

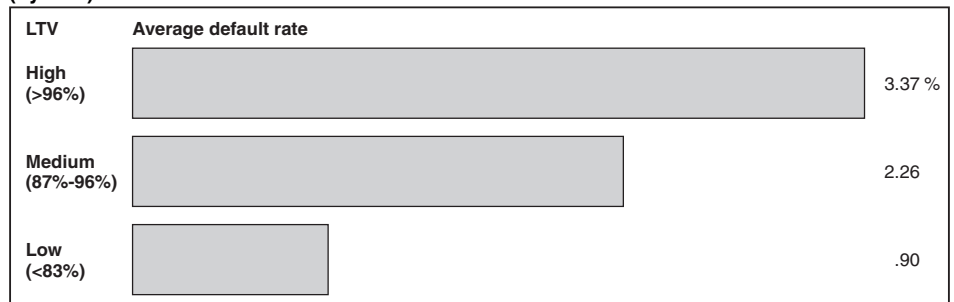
### What GAO Found

FHA and many other mortgage institutions provide many low and no down payment products with requirements that vary in terms of eligibility, borrower investment, underwriting, and risk mitigation. While these products are similar, there are some important differences, including that FHA has lower loan limits, allows closing costs and the up-front insurance premium to be financed in the mortgage, and permits the down payment funds to come from nonprofits that receive funds from sellers. FHA also differs in that it does not require prepurchase counseling.

A substantial amount of research GAO reviewed indicates that LTV ratio and credit score are among the most important factors when estimating the risk level associated with individual mortgages. GAO's analysis of the performance of low and no down payment mortgages supported by FHA and others corroborates key findings in the literature. Generally, mortgages with higher LTV ratios (smaller down payments) and lower credit scores are riskier than mortgages with lower LTV ratios and higher credit scores.

Some practices of other mortgage institutions offer a framework that could help FHA manage the risks associated with introducing new products or making significant changes to existing products. Mortgage institutions may impose limits on the volume of the new products they will permit and on who can sell and service these products. FHA officials question the circumstances in which they can limit volumes for their products and believe they do not have sufficient resources to manage a product with limited volumes. Mortgage institutions sometimes require additional credit enhancements, such as higher insurance coverage; and sometimes require stricter underwriting, such as credit score thresholds, when introducing a new low or no down payment product. FHA is authorized to require an additional credit enhancement by sharing risk through co-insurance but does not currently use this authority. FHA has used stricter underwriting criteria but this has not included credit score thresholds.

**Average Four-Year Default Rates for FHA Insured Loans Originated in 1998, 1999, and 2000 (by LTV)**



Source: FY 2003 Actuarial Review of the Mutual Mortgage Insurance Fund.