GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-07-615T, a testimony before the Subcommittee on Transportation, Housing and Urban Development, and Related Agencies, Committee on Appropriations, U.S. Senate

March 15, 2007

FEDERAL HOUSING ADMINISTRATION

Ability to Manage Risks and Program Changes Will Affect Financial Performance

Why GAO Did This Study

The Federal Housing Administration (FHA) has seen increased competition from conventional mortgage and insurance providers. Additionally, because of the worsening performance of the mortgages it insures, FHA has estimated that its single-family insurance program would require a subsidy—that is, appropriations—in fiscal year 2008 in the absence of program changes. To help FHA adapt to the evolving market, proposed changes to the National Housing Act would allow greater flexibility in setting insurance premiums and reduce down-payment requirements. To assist Congress in considering the financial challenges facing FHA, this testimony provides information from recent reports GAO has issued and ongoing work concerning the proposed legislation that address different aspects of FHA's risk management. Specifically, this testimony looks at (1) FHA's management of risk related to loans with down-payment assistance, (2) instructive practices for managing risks of new products, (3) FHA's development and use of its mortgage scorecard, and (4) FHA's estimation of program costs.

What GAO Recommends

In the reports discussed in this testimony, GAO made recommendations designed to improve FHA's risk management and estimates of program costs.

www.gao.gov/cgi-bin/getrpt?GAO-07-615T.

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

What GAO Found

Recent trends in mortgage lending have significantly affected FHA, including growth in the proportion of FHA-insured loans with down-payment assistance, wider availability of low- and no-down-payment products, and increased use of automated tools (e.g., mortgage scoring) to underwrite loans. Although FHA has taken steps to improve its risk management, in a series of recent reports, GAO identified a number of weaknesses in FHA's ability to estimate and manage risk that may affect its financial performance. For example:

- FHA has not developed sufficient standards and controls to manage risks associated with the substantial proportion of loans with down-payment assistance, including assistance from nonprofit organizations funded by home sellers. According to FHA, high claim and loss rates for loans with such assistance were major reasons for the estimated positive subsidy cost (meaning that the present value of estimated cash inflows would be less than the present value of estimated cash outflows) for fiscal year 2008, absent any program changes.
- FHA has not consistently implemented practices—such as stricter underwriting or piloting—used by other mortgage institutions to help manage the risks associated with new product offerings. Although FHA has indicated that it would impose stricter underwriting standards for a no-down-payment mortgage if the legislative changes were enacted, it does not plan to pilot the product.
- The way that FHA developed its mortgage scorecard, while generally reasonable, limits how effectively it assesses the default risk of borrowers. With increased competition from conventional mortgage providers, limitations in its scorecard could cause FHA to insure mortgages that are relatively more risky.
- FHA's reestimates of the costs of its single-family mortgage program have generally been less favorable than originally estimated. Increases in the expected level of claims were a major cause of a particularly large reestimate that FHA submitted as of the end of fiscal year 2003.

GAO made several recommendations in its recent reports, including that FHA (1) incorporate the risks posed by down-payment assistance into its scorecard, (2) study and report on the impact of variables not in its loan performance models that have been found to influence credit risk, and (3) consider piloting new products. FHA has taken actions in response to GAO's recommendations, but continued focus on risk management will be necessary for FHA to operate in a financially sound manner in the face of market and program changes.