CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 2, 2008

H.R. 5830

FHA Housing Stabilization and Homeownership Retention Act of 2008

As ordered reported by the House Committee on Financial Services on May 1, 2008

SUMMARY

CBO estimates that implementing this legislation would cost about $2.7 billion over the 2008-2013 period, assuming future appropriation actions consistent with the bill. Of that amount, about $1.7 billion would be needed for the estimated subsidy cost of insuring mortgages with a value of about $85 billion in a proposed new Federal Housing Administration (FHA) mortgage guarantee program.

H.R. 5830 would authorize—for up to four years—a new mortgage guarantee program under FHA that would allow certain at-risk borrowers to refinance their mortgages after the mortgage holder (lender or servicer) agrees to a write-down of the existing loan (that is, a reduction in the amount of loan principal). This new program would be established and overseen by the Refinance Program Oversight Board (Oversight Board), also established under this legislation. The bill would authorize the appropriation of $720 million over the 2008-2009 period for administrative support associated with this new program and to provide financial counseling services for certain borrowers.

In addition, the legislation would establish an Office of Housing Counseling within the Department of Housing and Urban Development (HUD) and authorize the appropriation of $183 million over the 2008-2011 period for grants to states, local governments, and nonprofit organizations to support counseling services and a public service campaign to publicize financial counseling for home buyers, homeowners, and renters. H.R. 5830 also would authorize the appropriation of $32 million over the 2008-2012 period for the Department of Justice (DOJ) to support efforts to combat mortgage fraud.

Finally, H.R. 5830 would increase by up to 75 percent the maximum guarantee that the Department of Veterans Affairs could provide to lenders who make loans to qualified veterans. Enacting that provision would reduce direct spending by $1 million in 2008. (The bill would not affect revenues.)

H.R. 5830 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 5830 is shown in the following table. The costs of this legislation fall within budget functions 370 (mortgage and housing credit), 700 (veterans benefits and services), and 750 (administration of justice).

	By Fiscal Year, in Millions of Dollars					
	2008	2009	2010	2011	2012	2013
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Homeownership Retention Loan Guarantee Program						
Estimated Authorization Level	174	599	447	292	190	0
Estimated Outlays	157	556	462	307	201	19
FHA Administrative Support and Counseling Services						
Authorization Level	360	360	0	0	0	0
Estimated Outlays	53	216	235	108	72	36
HUD Administrative Support for Office of Housing Counseling, Grants, and Public Service Campaign						
Estimated Authorization Level	61	61	61	61	16	16
Estimated Outlays	11	52	61	61	56	23
Funding for the Department of Justice						
Authorization Level	4	7	7	7	7	0
Estimated Outlays	3	7	7	7	7	1
Total Changes						
Estimated Authorization Level	599	1,027	515	360	213	16
Estimated Outlays	224	831	765	483	336	79
CHANGES IN DIRECT SPENDING						
Temporary Increase in Loan Guarantee Amount for Veterans Housing Loans						
Estimated Authorization Level	-1	*	0	0	0	0
Estimated Outlays	-1	*	0	0	0	0

Note: * = between -$500,000 and 0.

BASIS OF ESTIMATE

For this estimate, we assume that the bill will be enacted by June 1, 2008, that a supplemental appropriation will be provided during 2008 to operate the program, and that the new loan-guarantee program would operate for four years.

The bill's cost would stem mostly from the new FHA program and the authorized administrative support and loan counseling activities, subject to appropriation of the necessary funds. CBO estimates that the new loan guarantee program would cost $1.7 billion over the 2008-2013 period, while the administrative support and counseling would cost $720 million over that period. Other discretionary costs for implementing the bill would total about $296 million over the 2008-2013 period. The Congress could choose to provide a larger or smaller share of the program's multiyear cost in a 2008 supplemental appropriation than CBO has displayed in this estimate.

CBO estimates that under the new FHA loan-guarantee program, FHA would insure about 500,000 loans over the 2008-2013 period with an estimated average subsidy cost of about 2 percent of the loan principal. Assuming an average loan amount of $170,000 (after write-down of existing mortgages), we estimate that implementing H.R. 5830 would cost about $1.7 billion over the 2008-2013 period to pay for the estimated subsidy cost of the new program.

Features of the Proposed Homeownership Retention Loan Guarantee Program

The Oversight Board established by H.R. 5830 would include the Secretary of the Treasury, the Secretary of HUD, and the Chairman of the Board of Governors of the Federal Reserve System (Federal Reserve). It would establish operational procedures, including underwriting standards for mortgages, and it would oversee the new loan-guarantee program.

The proposed program would allow certain borrowers, who are at risk of defaulting on their mortgages, to refinance their home loans through a private lender with an FHA loan guarantee. To qualify for the program, the existing loans must be for an owner-occupied principal residence, have been originated on or before December 31, 2007, and meet other conditions specified in the bill.

Under the new program, the participating mortgage holder must agree to a loan refinancing arrangement that brings the loan-to-value (LTV) ratio on the new FHA-insured loan to no greater than 90 percent of the property's current appraised value. That change would result in a substantial reduction in the payment owed by the borrower each month. (The LTV ratio indicates how much equity a borrower initially has in the home—in this case, no less than

10 percent.) In addition to forgiving a portion on the debt of the existing loan, the mortgage holder would have to pay two fees: 3 percent of the original insured loan amount would be paid to FHA and not more than 2 percent of the original insured loan amount would be paid to cover origination costs and other closing costs for the new loan. In effect, the existing mortgage holder would take at least a 15 percent write-down on the value of the existing mortgage, and thus receive no more than 85 percent of the property's current value, after fees are taken into account.

In addition, the new loan would carry a fixed interest rate and be subject to the loan limits in place for FHA's single-family program at the time of the bill's enactment. This legislation also would require FHA to charge the borrower an annual fee of 1.5 percent of the remaining insured principal balance each year. Furthermore, the program would provide that, upon sale, refinancing, or other disposition of the residence, the borrower would pay to FHA the greater of a fee equal to 3 percent of the original insured loan amount or a declining percentage of any net proceeds realized, including any appreciation in the home's value. The percentage would start at 100 percent and reach 50 percent in the fourth year of the term of the new loan, and it would remain at that level for the duration of the loan.

The budgetary impact of the new loan program depends on how many loans would be refinanced under this voluntary program and the likelihood that borrowers would default on their refinanced mortgages.

Demand for the Homeownership Retention Loan Guarantee Program

Since the end of the unusual boom in homeownership and housing prices from 2003 to early 2006, delinquencies and foreclosures on mortgages have risen, particularly on subprime loans and alt-A loans. (Subprime loans are made to borrowers with low credit scores or other impairments to their credit histories. Alt-A loans are loans often made on the basis of little or no documentation of the borrower's income and may include low-downpayment loans, loans that are not for owner's principal residence, interest-only loans, and loans whose balances rise over time.) Because economic activity has slowed and house prices continue to decline in many areas of the United States, CBO expects that delinquencies and foreclosures on mortgage loans will continue to rise in the near term; in places where house prices have declined a great deal, some borrowers whose loan amount exceeds the value of their home may have little incentive to remain current on their loans.[1]

1 For additional details on the state of the nation's housing market, see: Congressional Budget Office, *Policy Options for the Housing and Financial Markets,* CBO Paper (April 2008).

Because use of the program is contingent on the voluntary participation of both lenders and borrowers, demand for this program to refinance qualifying mortgages under this legislation is uncertain. Furthermore, several factors would influence whether lenders and borrowers would perceive the new program as their best option.

Over the next four years, CBO estimates that about 500,000 borrowers would refinance troubled loans worth about $85 billion under this new program. The basis for this estimate of program volume is described below.

Number of Foreclosure Proceedings. Based on information from the Federal Reserve and mortgage industry data, CBO estimates that there are about 11 million subprime and alt-A mortgages outstanding, with a face value of over $2 trillion. Of those 11 million loans, we estimate that about 9 million are for owner-occupied houses.

CBO estimates that about 2.8 million borrowers with those loans will have foreclosure proceedings initiated against them at some point over the next four years. That estimate is tied to the historic performance of alt-A and sub-prime mortgage loans but adjusted for current macroeconomic conditions. Roughly 10-15 percent of those loans would enter foreclosure proceedings under more favorable conditions. However, given CBO's projections of house prices, interest rates, employment, and other factors, this rate was increased to about 30 percent.

While many of those 2.8 million loans that are estimated to enter the foreclosure process could be eligible for an FHA guarantee of a refinanced loan under this legislation, most would not be refinanced under the proposed program for several reasons.

Second Lien Holders. According to most mortgage industry participants that CBO consulted, the biggest impediment to the use of the proposed program is that participation is conditioned on the release of all existing liens on the loan. Second liens are very common for subprime and alt-A financing; based on information from loan servicers, CBO estimates that 40 percent of such loans carry second liens. Because first and second lien holders may have conflicting financial incentives, the opportunities for joint consent can be limited. That is, second lien holders may prefer to retain their existing loans with the expectation that borrowers' repayments will be greater in the future. In those instances, modifying the first mortgage outside of the proposed program may be more consistent with the second lien holder's interests. The intersection of willing first lien holders and willing second lien holders is more likely to occur when foreclosure is perceived by all parties to be truly imminent. Currently, about 40 percent of borrowers entering the foreclosure process actually lose their homes through a foreclosure sale.

This legislation would give the Oversight Board the authority to implement certain program features aimed at enticing second lien holders to voluntarily release their liens. One option would require the first lien holder to provide some amount of compensation to the second lien holder, based on a formula developed by the Oversight Board. What approach the Oversight Board would choose and ultimately how successful any approach would be is uncertain. Based on information from industry representatives, CBO estimates that about 25 percent of the loans with second liens could be refinanced under this new program. As home prices recover, however, second lien holders' incentive to retain their current position with the loans will increase. Accordingly, CBO estimates that in later years, about 20 percent of loans with second liens could be refinanced under the new program. Reducing the pool of potential participants because second liens would remain an impediment to program participation results in about 1.9 million loans that might be affected by the new program.

Adjustment for Other Factors. Many borrowers who would otherwise be eligible for this program would not participate because servicers will not able to contact some borrowers and some borrowers will not be able to avoid foreclosure because they have experienced a significant event, such as job loss, illness, divorce, or death. Reducing the pool of potential participants for those factors leaves about 1.4 million borrowers that could seek the new loan guarantees.

Participation by Mortgage Holders and Borrowers. CBO adjusted this eligible population of about 1.4 million borrowers to reflect expected levels of participation by mortgage holders and borrowers. Typically, much less than 100 percent of those eligible actually participate in federal benefit programs. Moreover, many factors would influence participation in the new program though, ultimately, the intersection of interests of both the mortgage holders and borrowers would determine the amount of participation.

Mortgage holders will evaluate loans that are eligible for the new FHA program and determine if the program would provide a better return than modifying the loans on their own, despite the risk of default. They will also evaluate whether the present value of the proceeds stemming from a modified loan under the new program is greater than or less than the value of proceeds from a foreclosure sale. Expectations regarding trends in house prices will greatly affect such calculations. Because mortgage holders may use different models to project future house prices, CBO expects that the behavioral responses by mortgage holders to the new program will vary considerably.

Borrowers also would have to decide whether participating in the program is a favorable option. In particular, borrowers would have to evaluate the profit-sharing provisions under the program and determine if forgoing some future profits on their homes is an acceptable arrangement even if foreclosure on their existing loans is the only alternative. Furthermore, some of the riskier borrowers with higher ratios of debt-to-income would be required to make six timely payments on the loan before being guaranteed by FHA; invariably, some of those borrowers would be disqualified from participating in the new program.

CBO estimates that fewer than 40 percent of the 1.4 million eligible loans would be refinanced under the new program. Following a reduction in the principal amount of those loans to make them affordable, CBO estimates that approximately 500,000 loans would be guaranteed under this legislation with an average loan amount of $170,000 each. Thus, CBO estimates that FHA would require about $85 billion in loan commitment authority over the next four years to implement the program. The legislation would authorize FHA to provide up to $300 billion in loan guarantees under the new program.

Subsidy Cost of the New FHA Loan Guarantee Program

Budgeting procedures for federal credit programs require that funds must be appropriated in advance to cover the estimated subsidy cost of loan guarantees on a present-value basis. CBO estimates that the new program would have a subsidy rate of about 2 percent of the loan value. This estimated subsidy rate assumes that the cumulative claims rate (default) for the program would be about 35 percent and that recoveries on defaulted mortgages would be about 60 percent of the outstanding loan amount. Those rates reflect CBO's view that mortgage holders would have an incentive to direct their highest-risk loans to the program, and are based on the expectation that the underwriting standards established for the new program would be less restrictive than those currently in place for FHA's single-family loan-guarantee program, thereby allowing FHA to insure loans with a greater risk of default. More-restrictive underwriting standards would lower the subsidy cost of the program but at the expense of lowering the number of borrowers able to participate.

Using an estimated subsidy rate of 2 percent and our estimate that demand for loan guarantees would equal $85 billion over the next four years, CBO estimates that implementing the new loan-guarantee program would cost $1.7 billion over the 2008-2013 period, subject to appropriation of the necessary amounts.

The Government National Mortgage Association (GNMA) is responsible for guaranteeing securities backed by pools of mortgages insured by the federal government. In exchange for a fee charged to lenders or issuers of the securities, GNMA guarantees the timely payments of scheduled principal and interest due on the pooled mortgages that back those securities. Enacting this legislation would require GNMA to guarantee securities backed by pools of the homeownership retention loans in an amount not to exceed $300 billion. CBO estimates that most of new federal loan guarantees made under this legislation would be included in GNMA's Mortgage-Backed Securities (MBS) program. CBO estimates that the subsidy rate for those securities would be close to zero. Thus, we estimate that implementing the MBS program under this legislation would result in a cost or savings of less than $500,000 a year over the 2008-2013 period, assuming enactment of appropriation laws necessary to implement the program.

Administrative Support for the Homeownership Retention Program and Funding for counseling Activities

H.R. 5830 would specifically authorize the appropriation of $720 million over the 2008-2009 period to pay FHA's administrative expenses associated with implementing the new loan-guarantee program and to support counseling and legal aid for certain borrowers. CBO estimates that outlays would total $720 million over the 2008-2013 period.

Public Service Campaign, Grants for Housing Counseling, and Administrative Support for the Office of Counseling

This legislation would establish the Office of Housing Counseling within HUD to support various activities relating to homeownership and rental housing counseling. Section 203 would authorize the appropriation of $3 million over the 2008-2010 period to support a national campaign to publicize the existence of counseling services for home buyers, homeowners, and renters. In addition, section 204 would authorize the appropriation of $45 million annually over the 2008-2011 period to provide grants to states, local governments, and nonprofit organizations to support counseling services. Based on information from HUD, CBO expects that funds for additional personnel, contractors, and information technology would be required to run the Office of Housing Counseling. CBO estimates that such support would cost $81 million over the 2008-2013 period. In total, CBO estimates that implementing those provisions would cost $264 million over the 2008-2013 period, assuming appropriation of the necessary amounts.

Funding for the Department of Justice

This legislation would specifically authorize the appropriation of $32 million over the 2008-2012 period for DOJ to support efforts to combat mortgage fraud. Most of this funding would be used to hire additional agents of the Federal Bureau of Investigation and additional prosecutors within the Offices of the United States Attorneys. Assuming that appropriations would be almost spread evenly over fiscal years 2008 through 2012, CBO estimates that enacting those provisions would cost $32 million over the 2008-2013 period.

Temporary Increase in Loan Guarantee Amount for Veterans Housing Loans

Section 104 would increase by up to 75 percent the maximum guarantee that VA could provide to lenders who make housing loans to qualified veterans. CBO estimates that the authority, which expires on December 31, 2008, would result in a small increase in the number of loans guaranteed by VA. Receipts from fees that the department charges for most of the loans it guarantees exceed its outlays for guarantee payments on defaulting loans. Therefore, the estimated subsidy cost is negative (-0.37 percent) and the additional loans that would be guaranteed under this authority would increase net receipts—by about $1 million in 2008 and less than $500,000 in 2009—CBO estimates.

Revenues

Section 102 of the bill would establish civil penalties (which are recorded in the budget as revenues) for certain violations related to real estate appraisals by interested parties in connection to the new loan guarantee program. CBO estimates that any increase in revenues resulting from those civil penalties would not be significant.

Sections 103 and 105 of the bill would require the Federal Reserve to conduct a study on the need for an auction or bulk refinancing mechanism to facilitate the refinancing of existing residential mortgages that are at risk of foreclosure and a study on the accounting standards applicable to depository institutions with respect to their residential mortgages that are at risk of foreclosure. Based on information from the Federal Reserve, CBO expects those studies would have no significant effect on the agency's workload or budget.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 5830 contains no intergovernmental or private-sector mandates as defined in UMRA. The bill would benefit state, local, and tribal governments by authorizing grants to support housing programs.

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