

CBO TESTIMONY

**Statement of
Marvin Phaup
Deputy Assistant Director for
Microeconomic and Financial Studies**

The Federal Housing Administration's Mutual Mortgage Insurance Fund

**before the
Subcommittee on Housing and Community Opportunity
Committee on Banking and Financial Services
U.S. House of Representatives**

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**CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515**

Madam Chair and Members of the Subcommittee, I am pleased to participate in today's hearing on the Federal Housing Administration's (FHA's) Mutual Mortgage Insurance Fund (MMIF). Your letter of invitation asked that the Congressional Budget Office (CBO) address the question of whether the MMIF has a surplus that can be spent on housing needs.

The short answer to that question is clearly no. Accumulations of premiums in excess of costs, as reflected in the accounting balance attributed the MMIF, do not constitute authority to spend. The MMIF's balance does not constitute budgetary resources. Under the Credit Reform Act, fees collected from borrowers are not available to make new loan guarantees. Appropriation actions are required before FHA can obligate federal funds to guarantee new loans. Through the appropriation process, the Congress approves the making of new FHA loan guarantees by setting an annual limit on the loan volume. (In 2001, that limit is \$160 billion.) It is that process—and not the existence of any balance in the MMIF—that provides the resources for FHA to make new loan guarantees.

In addition to the budgetary perspective are the actuarial and economic perspectives. The actuarial perspective, which is the focus of the annual review conducted for FHA by a contractor and to which a report by the General Accounting Office (GAO) responds, aims to assess the financial position of the MMIF in terms of its projected long-term cash inflows and outflows.¹ The economic perspective, by contrast, recognizes that the gross domestic product is the only source for funding future government obligations. That perspective assesses the success of government efforts to "reserve" funds for the future in terms of the effects on capital accumulation and the

1. Deloitte & Touche, *Actuarial Review of MMI Fund as of FY 1999* (prepared for the Department of Housing and Urban Development, January 2000), and General Accounting Office, *Mortgage Financing: FHA's Fund Has Grown, but Options for Drawing on the Fund Have Uncertain Outcomes*, GAO-01-460 (February 2001).

capacity of the economy to produce. While the actuarial and economic perspectives are both valid in principle, estimates of the extent to which the MMIF's income and costs balance each other and estimates of the MMIF's effects on the economy are too uncertain to support strong conclusions from either perspective. In any event, the MMIF has no capacity or authority to provide funding from its accounting balance to meet additional housing needs.

I would like to elaborate on this answer by observing that:

- The MMIF is a useful accounting device, but it is not a financial or corporate entity. It exists solely as a federal bookkeeping convention, albeit one that under current law has real consequences.
- Estimates of the economic value, or net position, of the MMIF provide policymakers with some useful information, but not spending authority or any other budgetary resources on which to base spending.
- Long-term estimates of the fund's balance are very uncertain, but they could have significant effects on policy.

THE MMIF'S BALANCE IS NOT A MEASURE OF BUDGETARY RESOURCES

The MMIF has no offices, no employees, and no authority to spend or do anything else other than what the Congress directs. The fund is not necessary to operate the government's mortgage insurance program for single-family housing.

Even if there was no MMIF, FHA could still have issued the \$94 billion in mortgage insurance that it did in 2000, provided it had received the authority to do so through the appropriation process. The resources used by the fund are the federal government's, as are all of its obligations and liabilities for the \$480 billion in loan guarantees currently outstanding.

Prior to the Credit Reform Act, many credit programs operated as revolving funds. The money that came in from fees and repayments was available for making new loans or guarantees. That arrangement is no longer the case. The authority to make new loan guarantees does not depend at all on up-front fees or on the repayments of previous loans. It simply requires appropriations (or in some cases, mandatory budget authority) sufficient to cover the costs of the loan programs.

Accordingly, it is misleading to refer to the fund as though it were a funding source on its own. No money is "deposited" or held in the fund; instead, premium receipts are consolidated with all other federal collections and managed by Treasury. The fund's balance is not an additional source of resources to the federal government, and the fund's financial position does not affect the government's ability or commitment to pay eligible claims. Rather, statements about the soundness or financial weakness of the fund should be interpreted as short-hand ways of describing whether the programs in the MMIF are operating in accord with the Congress's intent that income from premiums cover the programs' costs.

THE MMIF IS A SOURCE OF SOME USEFUL BUT UNCERTAIN INFORMATION

The fund is a means of tabulating and reporting actual and projected inflows of cash from premiums and outflows of the programs' cash costs. Monitoring the long-term balance between income and costs is extraordinarily difficult because of the long life of mortgage insurance contracts (up to 30 years), differences in the timing of premium receipts and payments for defaults, and the uncertainty of future economic conditions and policy changes that can affect both premium receipts and program costs.

Consequently, the balance between premiums and costs cannot be determined solely from recent experience. Assessing the long-run position of the fund requires adding the accumulated position from past guarantees to the projected cash inflows and outflows from all outstanding guarantees. As is well known, those projected future flows depend greatly on such unpredictable variables as interest rates, which affect loan prepayments, and house prices, which affect the frequency and costs of defaults.

Currently, the Subcommittee has at least two independent estimates of the net position of the MMIF as of the end of 1999: one from Deloitte & Touche, of \$16.6 billion, and one from GAO, of \$15.8 billion.² Both seem carefully done. Given their assumptions about the future, both conclude that current policy is consistent with the objective that premiums cover costs.

2. A new study of the fund's position at the end of 2000 has recently been released: Deloitte & Touche, *Actuarial Review of the Federal Housing Administration's Mutual Mortgage Insurance Fund as of Fiscal Year 2000* (prepared for the Department of Housing and Urban Development, December 2000).

As the GAO report demonstrates, however, various economic episodes that have occurred in the past could decrease the net position of the MMIF if they recurred. Thus, while it is useful to measure and monitor the fund's balance, estimates of the fund's net position are uncertain approximations of the true long-term relationship between premiums and costs. In any event, they are not a measure of the budgetary resources available to finance the fund's activities.

UNCERTAIN ESTIMATES OF THE MMIF'S BALANCE COULD HAVE REAL CONSEQUENCES

Under current law, estimates of the fund's financial balance can affect the terms under which federal mortgage insurance is offered to the public. The Congress has established a target value for the net position of the MMIF equal to 2 percent of insurance in force. If the estimated net position is above that threshold, the Secretary of Housing and Urban Development has discretion under current law to reinstitute the payment of distributive shares (rebates of insurance premiums to borrowers who prepaid their mortgages or otherwise terminated their mortgage insurance). The Secretary also has discretion to reduce the initial price of the insurance or to modify the underwriting standards.

Under current law, such policy changes are to be made only after the Secretary gives due consideration to the effects of those changes on the net position of the fund and to the need to minimize risks to the fund. The effects of such policy changes on the long-term balance of the fund are very difficult to estimate, and such estimates must be viewed as uncertain.

CONCLUSION

From all indications, Congressional efforts to ensure that the costs of programs included in the MMIF are paid for from premiums are succeeding. No one can be absolutely sure, but the estimates of the fund's net position—even with a 2 percent allowance for uncertainty—are consistent with that conclusion.

Nevertheless, it is clear that accumulations of premiums over costs in the MMIF do not constitute authority to spend more money on housing programs. Only the Congress, through the appropriation process, can provide FHA with the authority to make new loan guarantees.

Steps could be taken to improve the information available about the financial condition of the MMIF. One step would be to develop systematic estimates of the expected volatility of the fund's net position based on the assumption that policy is unchanged. That endeavor would help assess the adequacy of the 2 percent reserve. Further, as the GAO report emphasizes, policymakers need better information on the effects of specific policy changes on the MMIF's financial balance. The understanding of those relationships is crude but improving; significant advances in analysts' ability to project the effects of policy changes, including changes in the underwriting standards, can be anticipated over the next several years. Armed with that information, the Congress will be better able to ensure that premiums pay the long-term costs of insurance. In the meantime, the Congress needs to be fully aware of the useful aspects but qualitative limitations of the current estimates of the MMIF's net position.

