GAO Accountability·Integrity·Reliability
Highlights

Highlights of GAO-05-875, a report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

September 2005

MORTGAGE FINANCING

FHA's $7 Billion Reestimate Reflects Higher Claims and Changing Loan Performance Estimates

Why GAO Did This Study

The U.S. Department of Housing and Urban Development (HUD), through its Federal Housing Administration (FHA), provides insurance for private lenders against losses on home mortgages. FHA's largest insurance program is the Mutual Mortgage Insurance Fund (Fund), which currently is self-financed and operates at a profit. FHA submitted a "reestimate" of $7 billion for the credit subsidy and interest for the Fund as of the end of fiscal year 2003, reflecting a reduction in estimated profits. Given this substantial reestimate, you asked GAO, among other things, to determine what factors contributed to the $7 billion reestimate and the underlying loan performance variables influencing these factors and to assess how the loan performance variables underlying the reestimate could impact future estimates of new loans.

What GAO Recommends

To more reliably estimate program costs, the Secretary of HUD should direct the FHA Commissioner to study and report the impact of variables that have been found in other studies to influence credit risk. When changing the definitions of key variables, FHA also should report the impact such changes would have had on the forecasting ability of its loan performance models. In written comments, HUD generally agreed with GAO's overall findings.

www.gao.gov/cgi-bin/getrpt?GAO-05-875.

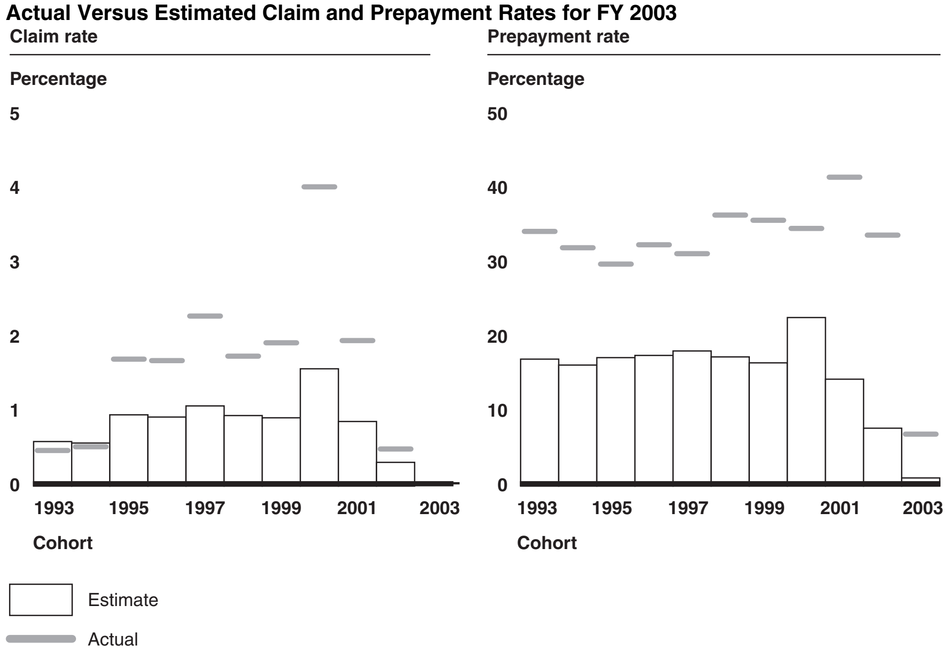
To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

The $7 billion reestimate was due primarily to an increase in estimated and actual claims over what FHA previously estimated. For example, actual claim activity in fiscal year 2003 exceeded estimated claim activity for 2003—by twice as much in some cases—for the majority of loan cohorts. Prepayments also played a role in the reestimate as they were higher than previous estimates. In fact, actual prepayment activity during 2003 exceeded estimated prepayment activity for all cohorts. Because of the additional claims it paid, upfront premiums it refunded, and the annual premiums it lost, FHA's net cash outflows for the year increased, contributing to the $7 billion adjustment of the Fund's credit subsidy.

Several recent events may help explain this increase, including changes to underwriting guidelines, competition from the private sector, and an increase in the use of down payment assistance. FHA has taken some steps to tighten underwriting guidelines and better estimate loan performance, though it is not clear that these steps are sufficient to reverse recent increases in actual and estimated claims and prepayments or help FHA to more reliably predict future claim and prepayment activity. Increases in claim and prepayment activity are likely to continue to add risk to FHA's portfolio.

Actual Versus Estimated Claim and Prepayment Rates for FY 2003



Source: GAO analysis of FHA data.