GAO Highlights

Highlights of GAO-13-682, a report to congressional requesters

Why GAO Did This Study

FHA has historically provided mortgage guarantees for home buyers, particularly first-time, minority, and lower-income borrowers. In 2012, FHA insured about $227 billion in single-family mortgages, and its overall insurance portfolio was about $1.1 trillion. Its market presence expanded during the recent housing crisis as the conventional market contracted and Congress increased the limit on the size of loans FHA may insure. But FHA's financial condition has weakened, and FHA has not met its 2 percent statutory minimum capital ratio since 2009. In its most recent budget, the agency stated that its capital reserve account might require an infusion of federal funds.

FHA, industry participants, and researchers have suggested a number of options for improving FHA's long-term viability or for limiting FHA's market presence. These options have potential implications for taxpayers, borrowers, and others. This report discusses the options—which fall into three broad categories: (1) changes to product terms and conditions, (2) changes that would restrict FHA's market presence, and (3) changes to FHA's operations and powers—and their implications. It also describes the possible effects of broader housing finance reform on FHA.

GAO interviewed a variety of industry stakeholders and researchers and reviewed studies and other documents to identify options for reforming FHA and their implications.

View GAO-13-682. For more information, contact Mathew J. Scirè at (202) 512-8678 or sciremj@gao.gov.

September 2013

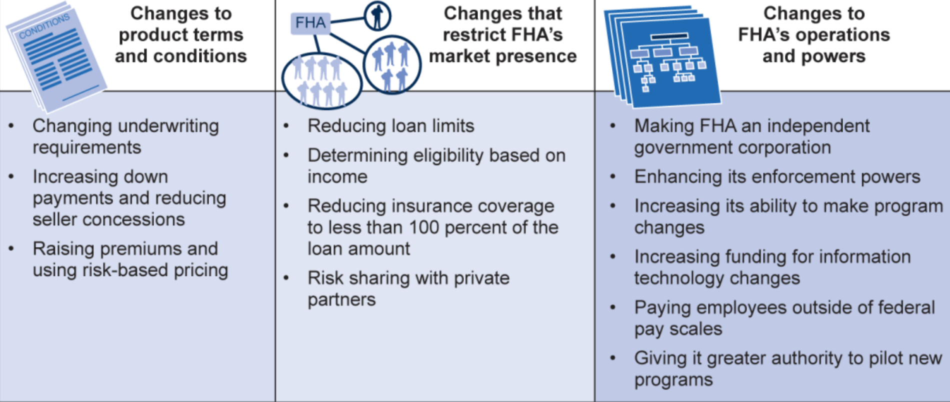
FEDERAL HOUSING ADMINISTRATION

Analysis of Options for Modifying Its Products, Market Presence, and Powers

What GAO Found

GAO identified a number of proposed options for adjusting product terms and conditions to help improve the Federal Housing Administration's (FHA) long-term viability (see fig. below). FHA has raised the premiums that it charges borrowers several times in recent years and has taken steps to tighten its underwriting standards—for example, by setting a minimum required credit score. Some mortgage market observers have argued that further changes such as revising underwriting standards to focus on borrowers' residual income, requiring higher down payments, or reducing seller concessions (that is, funds sellers provide to buyers to help pay for closing costs) could help FHA better manage credit risk. However, such changes would entail trade-offs. For instance, some said that raising down-payment requirements would improve loan performance, but others said that this move would delay homeownership for many borrowers. Similarly, raising premiums could potentially increase revenue, but this potential would be constrained if it caused volume to decline. Further, low-risk borrowers with fewer down-payment constraints could choose less costly loans from other sources, leaving FHA with more high-risk borrowers. These changes could have a direct effect on the availability of credit for borrowers.

Options to Improve FHA's Long-Term Viability or Reduce Its Market Presence

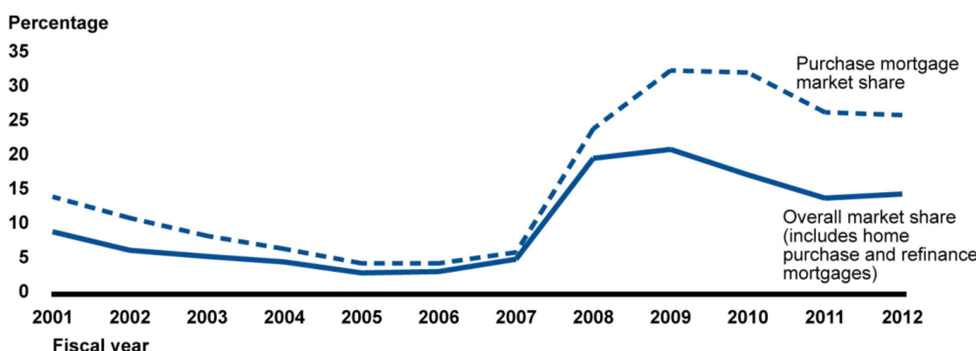


Source: GAO.

GAO also identified options that could either directly or indirectly change FHA's market presence, which increased after the housing crisis, or address its financial viability (see fig. below). Among the proposals that would have a direct effect are those limiting FHA insurance to loans below a lowered ceiling or to borrowers who met new income guidelines. Many stakeholders and FHA itself view FHA's current loan limits, which range from $271,050 to $729,750 for one-unit properties in the contiguous United States, as too high. Some note that the agency may insure larger loans than the housing enterprises Fannie Mae and Freddie Mac. The current FHA limits were put in place in response to declines in mortgage lending during the housing crisis, when the private sector's role in financing mortgages shrank. However, as the market has improved, some have noted that lowering loan limits would allow private capital to return to the market

and focus FHA on low- and moderate-income and first-time home buyers, a shift that many observers consider appropriate. Other proposed changes, such as reducing insurance coverage to less than 100 percent of the loan amount or entering into risk-sharing agreements with private partners, may indirectly reduce FHA's market presence. However, applying a partial coverage model would limit availability of credit to some borrowers. For some lenders, the additional exposure might prompt the purchase of additional insurance coverage from third parties, the cost of which would be passed on to borrowers. Some argue that under a risk-sharing structure private partners would assume and better manage credit risk. But creating such a structure would require careful consideration of how risks are borne, how pricing is determined, how incentives are aligned between FHA and its partners, and how FHA's role in stabilizing mortgage markets would be impacted. Others point to the additional counterparty risk posed by risk-sharing arrangements, which would necessitate greater federal oversight. Finally, these options might also affect FHA's ability to respond to changing market conditions.

FHA's Share of Loan Originations, 2001-2012



Source: GAO analysis of HUD data.

FHA and industry observers have also suggested changes to FHA's structure and powers that could enhance its flexibility and capacity to manage risk. Some of these changes would bring FHA's corporate powers more in line with those of other government corporations and increase its autonomy, providing it with enhanced enforcement powers and greater authority to change program requirements and invest in staff and technology. FHA has already requested additional enforcement authority. FHA and other observers have also argued that FHA needs greater power to change loan products or loan features without a lengthy rulemaking process and additional information technology resources—resources for which FHA must currently compete within HUD. Expanding FHA's operational and managerial powers would give the agency more flexibility, and increasing its enforcement powers would allow it to more effectively oversee lenders. But any expansion of FHA's authority may need to be limited and transparency requirements heightened, including for the rulemaking process. Even with no changes to its existing organizational structure and authorities, FHA can do more to enhance program efficiency and effectiveness and protect taxpayers. GAO has made a number of recommendations aimed at improving FHA's loss mitigation efforts, management of real-estate owned inventories, risk assessment, human capital management, and information technology systems. In response to these recommendations, FHA has taken steps, such as developing a plan for conducting an inaugural risk assessment and a workforce analysis and succession plan.

Finally, efforts to further regulate housing finance and the continuing uncertainty over resolution of Fannie Mae and Freddie Mac present challenges to any efforts to reform FHA. Following the collapse of the mortgage market, Congress passed a number of mortgage reforms that could impact FHA's market share and role because they could affect the price at which the conventional market will be able to serve future home buyers of varying credit risk profiles. Similarly, the administration has put forth several options for reforming the federal role in the mortgage market, including reform of Fannie Mae and Freddie Mac. Each of these options could have an impact on FHA's role in the mortgage market. Partly for this reason, GAO identified modernization of the federal role in housing finance as a high-risk area in early 2013. Any changes to the federal tools that support housing finance should be made in concert and with full recognition of the interdependence among FHA, the enterprises, and federal regulation.