CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 12, 2007

FHA Modernization Act of 2007

As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on September 19, 2007

SUMMARY

This legislation would amend the National Housing Act to provide the Federal Housing Administration (FHA) with new authorities aimed at expanding FHA's share of the market for mortgage insurance. This legislation also would permanently remove the statutory limitation on the number of reverse mortgages that FHA can insure and would make other changes to the Home Equity Conversion Mortgage (HECM) program. In addition, this legislation would authorize the appropriation of funds to support various improvements to FHA's administrative functions and would modify FHA's loan guarantee program for manufactured housing.

CBO estimates that implementing this legislation would result in a net cost of $22 million in 2008 and a net increase in offsetting collections (a credit against discretionary spending) of $1.6 billion over the 2008-2012 period, assuming that appropriation laws necessary to implement the FHA programs and the Mortgage-Backed Securities (MBS) program of the Government National Mortgage Association (GNMA) are enacted.

Enacting this legislation could affect direct spending and revenues because the bill would impose criminal penalties for certain fraudulent acts committed against FHA. Criminal fines are recorded as revenues, then deposited in the Crime Victims Fund, and later spent (as direct spending). CBO estimates that any increase in criminal penalties would not be significant.

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

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the bill is shown in the following table. The cost of this legislation falls within budget function 370 (mortgage and housing credit). For this estimate, CBO assumes that this legislation will be enacted near the start of fiscal year 2008, that the amounts necessary to implement the bill will be appropriated for each year, and that appropriation laws necessary to implement the FHA and GNMA programs will be enacted each year.

BASIS OF ESTIMATE

CBO estimates that implementing this legislation would result in a net increase in offsetting collections of $1.6 billion over the 2008-2012 period, assuming enactment of appropriation laws necessary to implement the FHA and GNMA programs. Those estimated offsetting collections would mostly stem from the authority in the legislation to expand FHA's HECM loan program. Other offsetting collections for GNMA would result from the change to the loan limits for FHA's single-family program. Additional discretionary costs associated with limiting a planned increase in mortgage insurance fees and authorizing the appropriation of funds to support various improvements to FHA's administrative functions would increase costs subject to appropriation.

CBO expects that other provisions of the bill would have no significant budgetary impact over the next five years. The major provisions of the bill are discussed below.

	By Fiscal Year, in Millions of Dollars				
	2008	2009	2010	2011	2012
SPENDING SUBJECT TO APPROPRIATION					
Net FHA and GNMA Spending Under Current Law [a]					
Estimated Authorization Level	-913	-425	-425	-425	-425
Estimated Outlays	-913	-425	-425	-425	-425
Proposed Changes					
Amendments to HECM Loan Program					
Estimated Authorization Level	-10	-385	-410	-445	-480
Estimated Outlays	-10	-385	-410	-445	-480
Additional GNMA Offsetting Collections					
HECM Provisions					
Estimated Authorization Level	*	-6	-6	-10	-15
Estimated Outlays	*	-6	-6	-10	-15
Raising Loan Limit for the Single-Family Program					
Estimated Authorization Level	-7	-8	-9	-10	-11
Estimated Outlays	-7	-8	-9	-10	-11
Limit on Premium Increases for Mortgage Insurance					
Estimated Authorization Level	20	43	0	0	0
Estimated Outlays	20	43	0	0	0
Improving FHA Administrative Functions					
Estimated Authorization Level	25	25	25	25	25
Estimated Outlays	19	25	25	25	25
Amendments to Manufactured Housing Loan Guarantee Program					
Estimated Authorization Level	0	*	*	*	*
Estimated Outlays	0	*	*	*	*
Total Changes					
Estimated Authorization Level	28	-331	-400	-440	-481
Estimated Outlays	22	-331	-400	-440	-481
Net FHA and GNMA Spending Under Legislation.					
Estimated Authorization Level	-885	-756	-825	-865	-906
Estimated Outlays	-891	-756	-825	-865	-906

Note: GNMA = Government National Mortgage Association; HECM = Home Equity Conversion Mortgage; MBS = Mortgage-Backed Securities; FHA = Federal Housing Administration; * = costs or savings of less than $500,000.

a. The figures for 2008 are CBO's current estimates of budget authority and outlays for FHA's multifamily programs, the HECM program, and GNMA's MBS program under Public Law 110-92. CBO annualizes the budget authority provided under continuing resolutions. The 2009-2012 amounts are CBO's baseline estimates of the net offsetting collections that would be generated by those programs, assuming that appropriation laws necessary to implement FHA and GNMA programs are enacted. Also included in the figure for 2008 is the estimated portion of the total credit subsidy appropriated for that year (i.e., $1 million) that will be used by FHA for the manufactured housing loan guarantee program.

Amendments to the HECM Loan Insurance Program

HECM loans are considered to be "reverse mortgages" because they enable homeowners who are at least 62 years of age to withdraw some of the equity in their homes in the form of monthly payments, in a lump sum, or through a line of credit. Loan size is tied to loan limits that vary by geographic region, and such loans cannot be used to purchase another home. In addition, the origination fee charged by lenders is calculated as a percentage of the home's value.

FHA is permitted to guarantee up to a cumulative total of 275,000 loans; that number of loans was reached during 2007. The current continuing resolution (Public Law 110-92) eliminates the limit on the number of HECM loans FHA can insure through November 16, 2007. Consistent with CBO's standard convention of extrapolating a continuing resolution through the remainder of the fiscal year, this estimate is based on the assumption that there will be no limit on the number of HECM loans guaranteed in fiscal year 2008. In the absence of this bill, CBO assumes that the HECM program will be inactive beginning in 2009.

Enacting this legislation would permanently remove the statutory limitation on the number of loans that could be guaranteed, set a single nationwide limit on the dollar amount of a HECM loan that would be tied to the conforming loan amount, limit the origination fee to 1.5 percent of the home's value (subject to a minimum allowable amount), and allow borrowers to use HECM loans to purchase a new home. (Conforming loans have terms and conditions that follow the guidelines set forth by the government-sponsored enterprises (GSEs); the conforming loan amount is currently $417,000.)

Implementation of the HECM program, like all of FHA's mortgage insurance programs, is contingent on the enactment of appropriation laws that provide annual loan commitment authority. Thus, the estimated budgetary impact of this bill is considered to be discretionary, and it is tied to the demand for HECM loans and the estimated subsidy cost of the loan guarantees. Because, under credit reform procedures, guarantees of HECM loans are estimated to have negative subsidies (that is, they earn money for the government), CBO estimates that implementing those amendments would increase offsetting collections by about $1.7 billion over the 2008-2012 period.

Demand for HECM Loans. According to the National Reverse Mortgage Lenders Association (NRMLA) and other industry experts, the HECM program has risen in popularity in recent years. As more consumers are becoming aware of the product, more households are becoming eligible for the program (currently over 17 million households have owners who are age 65 or older, according to census data), and more seniors view the product as an alternative approach to financing home-improvement projects, medical costs, and other needs. In addition, sources in the mortgage industry have observed an increasing demand among seniors for new housing within senior communities. The number of HECM loans insured by FHA quadrupled from 2003 to 2006 (18,000 loans were insured in 2003, compared with 76,000 loans in 2006). Furthermore, based on the number of HECM loans insured as of mid-September 2007, that volume could reach 105,000 after final loan volume for 2007 is tallied by FHA.

Based on information from FHA, NRMLA, and other industry experts, CBO estimates that setting a single nationwide loan limit and permitting borrowers to use HECM loans to purchase a new home would result in a product that would be more attractive to borrowers and more easily marketed by lenders, resulting in some increased demand for HECM loans. On the other hand, the limit on the origination fee could result in a program that is less profitable for certain lenders, causing some to end or limit their participation in the program. A lower origination fee, however, could increase the program's attractiveness to some borrowers, assuming lenders do not increase interest rates significantly to compensate for lower origination fees. CBO anticipates that the bill would result in a higher volume of HECM loans than would occur under the provisions of the continuing resolution, thus increasing offsetting collections by $10 million in 2008.

Currently, the market for FHA's HECM loans appears to be very robust, and under this bill, FHA would probably insure more than 110,000 loans annually beginning in 2009. Also, GNMA's recent decision to begin securitizing HECM loans could result in increased activity by lenders, as investors in the secondary mortgage market begin to invest in mortgage-backed securities that include this product. Whether the number of guarantees could exceed 110,000 loans on a continuing basis each year would depend on FHA's ability to administer and manage the program in an efficient manner and on the market's response to this bill. Based on information from FHA, CBO estimates that the agency could insure about 112,000 loans (with a face value of about $28 billion) in 2009. In subsequent years, we estimate that demand would increase at the estimated rates of appreciation in housing prices—about 2 percent to 4 percent a year.

Subsidy Cost. Under current law, FHA guarantees of HECM loans are estimated to result in net offsetting collections to the federal government because guarantee fees for those mortgages are currently estimated to more than offset the costs of expected defaults. For 2008, the Department of Housing and Urban Development's (HUD's) subsidy estimate for HECM loan guarantees is -1.9 percent. Under the expanded program authorized by this legislation, CBO estimates that the subsidy rate for the HECM loans would be -1.35 percent. This reduction from the estimated rate for 2008 is due to the increased risk FHA would experience under the proposed nationwide loan limitation. With larger loan sizes, the "equity cushion" (that is the difference between the home's value and the potential cost of a claim payment) would decrease, leading to potentially more costly claims for FHA. CBO estimates that implementing this legislation would result in additional offsetting collections of $1.7 billion over the 2008-2012 period, contingent on enactment of appropriation bills that would establish the authority to make HECM loan guarantees by specifying annual loan commitment levels.

Additional GNMA Offsetting Collections from HECM Provisions

GNMA is responsible for guaranteeing securities backed by pools of mortgages that are 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. Because, under credit reform procedures, the value of the fees collected by GNMA is estimated to exceed the cost of loan defaults in each year, the Administration estimates that the GNMA MBS program will have a subsidy rate of -0.21 percent in 2008, resulting in the net collection of receipts to the federal government.

Currently GNMA does not securitize HECM loans; according to GNMA, however, securitization of those loans will begin sometime 2008. CBO estimates that in 2008 about 5 percent of the HECM loans will be included in GNMA's MBS program. (Only a small portion of this 5 percent would stem from the changes made to the HECM program in 2008 under this legislation.) We estimate that in subsequent years, 10 percent to 20 percent of the HECM loans would be securitized by GNMA. Thus, CBO estimates that the changes to the HECM loan program in this bill would result in additional offsetting collections to GNMA, totaling about $37 million over the 2008-2012 period, assuming appropriation action to establish a dollar limitation for the GNMA securities program.

Raising Loan Limits for the Single-Family Program

Section 102 would raise FHA's loan limit—the dollar amount of a mortgage that FHA can insure—for its single-family program from 87 percent of the conforming loan amount to 100 percent of the conforming loan limit in certain geographic regions where the cost of housing is very high. Effectively, this would be a change from insuring loans of $362,790 today to insuring loans of up to $417,000 in certain parts of the country. In less expensive markets, the limit would be raised from 48 percent to 65 percent of the conforming loan limit, or an increase in the ceiling from $200,160 to $271,050 under the bill.

CBO estimates that implementing this provision would increase loan volume by about 8 percent a year—about $4 billion annually in additional loan guarantees—over the next five years. This increase would stem mostly from increasing the limit in the less expensive housing markets. Despite this estimated increase in loan volume, CBO estimates that no additional offsetting collections would be realized because we expect the subsidy rate for the single-family program to be zero over the next five years. However, because most FHA single-family loan guarantees are included in GNMA's MBS program, CBO estimates that raising the loan limit would result in additional offsetting collections to GNMA of about $45 million over the 2008-2012 period. (Because GNMA requires appropriation action to establish its dollar limitation for the securities program, those savings would be offsets to discretionary spending.)

Limit on Premium Increases for Mortgage Insurance

Currently, FHA has the authority to adjust fees for its mortgage insurance programs through administrative action. Section 120 would prohibit FHA from increasing fees through 2009 unless the increase is required to maintain the estimated credit subsidy for the program at zero, but not less than zero. Based on information from the Administration, CBO expects that annual fees for new loan guarantees for the apartment development and refinance programs will increase by about 16 basis points beginning in early 2008. The weighted average subsidy rate for those programs is currently about -2 percent. CBO estimates that those fee increases would affect about $2.6 billion in loan guarantees in 2008 and more than $3 billion in loan guarantees annually in subsequent years. Furthermore, we estimate that those fee increases would increase offsetting collections for this program by $63 million over the 2008-2009 period. Thus, prohibiting those fee increases would result in a loss—relative to the current-law baseline—of $63 million in discretionary offsetting collections over the 2008-2009 period.

Improving FHA's Administrative Functions

Section 116 would authorize the appropriation of $25 million annually over the 2008-2012 period. Such funding would be used to improve FHA's technologies, processes, and overall program performance associated with the execution of its mortgage insurance programs. CBO estimates that implementing this section would cost $119 million over the 2008-2012 period. Those funds would not be authorized to be appropriated each year unless HUD, by rule, determines that FHA premiums being charged that year are sufficient to comply with the Mutual Mortgage Insurance Fund's (MMIF's) capital ratio requirement and are also sufficient to ensure the safety and soundness of other FHA mortgage insurance funds.

In addition, section 118 would require HUD to establish a three-year demonstration program to test the effectiveness of various forms of pre-purchasing financial counseling. HUD already provides several types of housing counseling services, and CBO expects that implementing the pilot program would result in no significant additional costs to the federal government. However, this section also would allow (but not require) HUD to reduce mortgage insurance premiums for certain borrowers who agree to participate in a counseling program. Such fee reductions could increase the subsidy rate for the affected loan guarantees. (The Federal Credit Reform Act of 1990 requires the appropriation of funds to cover subsidy costs of loan guarantees.) The cost of this provision would depend on the degree of any fee reduction provided and other risk factors associated with those borrowers, which have not been determined by FHA. CBO estimates that such costs would probably not be significant, given that only 3,000 borrowers could participate in the demonstration program.

Amendments to the Manufactured Housing Insurance Program

Guarantees of manufactured housing loans fall under title I of the National Housing Act. Under that act, FHA has authority to insure home improvement loans. The volume of manufactured housing loans guaranteed by FHA has fallen from 30,000 per year in the 1990s to fewer than 2,000 loans per year in recent years. Furthermore, in the late 1990s GNMA experienced significant losses from its securitization of those manufactured housing loans. As a result of those losses, GNMA imposed a moratorium on new issues of securities for those loans.

Moreover, financing options for manufactured housing are very limited. Currently, only two private lenders participate in the FHA program, and because no private secondary market exists, most private lenders and insurers have no incentive to make loans or loan guarantees for manufactured housing. Despite the fact that there are relatively few financing options available for manufactured housing, there are about 11 million manufactured homes in the United States (mostly in rural areas), according to the Manufactured Housing Institute (MHI). Most of those manufactured houses are financed through personal loans. Title II of this legislation would make several amendments designed to increase demand for FHA's manufactured housing loan program.

Proposed Changes. Under current law, FHA limits its exposure to losses from manufactured housing loan guarantees by capping the lender's insurance coverage at 10 percent of the value of the lender's portfolio for the title I program. That is, FHA pays only lender claims that total no more than 10 percent of the value of the lender's loan portfolio for the title I loans. As a result, the amount of insurance that FHA provides for each loan varies. Enacting this legislation would eliminate this insurance structure for loans associated with manufactured homes and would direct FHA to insure 90 percent of each individual loan. That change would significantly expand the government's liability under the program.

Title II of this legislation also would raise the loan limit for insuring a manufactured home by about 40 percent and would require that the limit be indexed for inflation on an annual basis. According to FHA, the average cost of a manufactured home is about $60,000. Current law limits FHA to guaranteeing the purchase of manufactured homes to $48,000; under the legislation, this limit would increase to $69,678 after the program changes are implemented in 2009.

Currently, borrowers are charged a 1 percent up-front fee for a manufactured home loan guarantee. Because the fees collected are not expected to exceed the cost of defaults, FHA estimates that the manufactured housing loan guarantee program has a subsidy rate of about 1 percent. Enacting this legislation would require FHA to assess higher premiums to offset the cost of expected defaults to yield an estimated negative credit subsidy rate for the program. Based on information from FHA, CBO expects that FHA would set the up-front premium for borrowers at about 2.25 percent and the annual premium at 1 percent. CBO expects that those fees would be sufficient to make the program's estimated subsidy rate close to zero, assuming that the pattern of future default rates in this program is similar to recent history—about 9.5 percent. Because there is essentially no private market for manufactured housing loan guarantees to compare to the federal program, it is uncertain whether those higher fees would result in a program with no net cost. On balance, CBO estimates that implementing the manufactured housing provisions would result in net costs or savings of less than $500,000 a year beginning in fiscal year 2009.

Cost of Program. Based on information from FHA and MHI, CBO estimates that it would take about one year to implement the changes proposed under the bill. Furthermore, CBO anticipates that significant outreach by FHA would be needed to identify and educate prospective borrowers and lenders about the manufactured housing program reforms. Thus, CBO estimates that the number of loans insured under the program would begin to grow by about 5 percent annually beginning in 2009. Assuming this gradual increase in demand and an estimated subsidy rate for 2009 and subsequent years that is near zero, CBO estimates that implementing this legislation would result in a net cost or savings of less than $500,000 a year over the 2009-2012 period.

GNMA Savings. According to GNMA, the agency would consider securitizing additional manufactured housing loans following an evaluation of the program after the proposed changes are implemented and to the extent FHA has begun to guarantee a significant number of loans, most likely with a face value close to at least $1 billion. Because CBO estimates that it would take FHA many years to increase its business volume to that level, we estimate that the manufactured housing provisions would not generate any additional offsetting collections associated with GNMA's MBS program over the next five years.

Fees and Downpayment Requirements

Currently, FHA's single-family loan guarantee program has a flat premium structure under which all borrowers pay the same up-front and annual fees, regardless of the borrower's individual risk of default. Based on information from FHA, CBO expects that, in 2008, the up-front fee will increase from 1.5 percent to 1.66 percent and the annual fee will rise from 0.5 percent to 0.55 percent. (The maximum fees allowable under current law are 2.25 percent for the up-front fee and 0.55 percent for the annual fee.) HUD estimates that those fee increases will result in a subsidy rate of zero for the single-family program for 2008.

Under this legislation, FHA would have the authority to raise the up-front premium to 3 percent and to offer guarantees for loans with downpayments as low as 1.5 percent of the principal loan amount. Because the subsidy rate for 2008 is estimated to be zero under current law, CBO expects that FHA, with these new authorities, would continue to charge fees under this bill that would produce a similar result.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

The legislation contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

PREVIOUS CBO ESTIMATES

On June 1, 2007, CBO transmitted a cost estimate for H.R. 2139, the FHA Manufactured Housing Loan Modernization Act of 2007, as ordered reported by the House Committee on Financial Services on May 23, 2007. H.R. 2139 and title II of this legislation would make the same changes to the manufactured housing insurance program; thus, the costs associated with this program are identical in the two estimates.

On June 11, CBO transmitted a cost estimate for H.R. 1852, the Expanding American Homeownership Act of 2007, as ordered reported by the House Committee on Financial Services on May 3, 2007. Both H.R. 1852 and this legislation contain nearly identical provisions affecting the HECM program, the loan limits for FHA's single-family program, and FHA's administrative functions. The costs associated with those provisions are estimated to be the same for the two bills beginning in 2009. In addition, both bills include provisions limiting fee increases for certain FHA loan guarantees, though the provision in H.R. 1852 would make the limitation permanent while the provision in this legislation would extend the limitation only through 2009. This difference is reflected in the cost estimates.

Other differences exist between the two bills, and those differences are also reflected in the cost estimates.

On September 12, 2007, CBO transmitted a cost estimate for H.R. 2895, the National Affordable Housing Trust Fund, as ordered reported by the House Committee on Financial Services on July 31, 2007. Similar to H.R. 1852, H.R. 2895 includes a provision to permanently limit fee increases for certain FHA loan guarantees.

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