



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

September 18, 2002

S. 2239

FHA Downpayment Simplification Act of 2002

*As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs
on September 12, 2002*

SUMMARY

S. 2239 would permanently change the process the Federal Housing Administration (FHA) uses to determine the amount of a down payment that is necessary for mortgages on the single-family homes that it insures. This legislation also would repeal a 3 basis point increase in the Government National Mortgage Association's (GNMA's) guarantee fee, scheduled to be implemented in 2005 under current law.

CBO estimates that implementing this legislation would cost \$6 million in 2003 and \$213 million over the 2003-2007 period, assuming appropriation action consistent with the bill. Enacting this bill would not affect direct spending or receipts. Therefore, pay-as-you-go procedures would not apply.

S. 2239 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 S. 2239 is shown in the following table. The costs of this legislation fall within budget function 370 (mortgage and housing credit).

	By Fiscal Year, in Millions of Dollars					
	2002	2003	2004	2005	2006	2007
SPENDING SUBJECT TO APPROPRIATION						
FHA and GNMA Spending Under Current Law						
Estimated Authorization Level ^a	-2,854	-3,100	-3,107	-3,187	-3,267	-3,348
Estimated Outlays	-2,854	-3,100	-3,107	-3,187	-3,267	-3,348
Proposed Changes						
Down-Payment Simplification						
Estimated Authorization Level	0	6	8	8	9	9
Estimated Outlays	0	6	8	8	9	9
GNMA Guarantee Fee						
Estimated Authorization Level	0	0	0	56	58	59
Estimated Outlays	<u>0</u>	<u>0</u>	<u>0</u>	<u>56</u>	<u>58</u>	<u>59</u>
Total Changes						
Estimated Authorization Level	0	6	8	64	67	68
Estimated Outlays	0	6	8	64	67	68
Total Spending Under S. 2239						
Estimated Authorization Level	-2,854	-3,094	-3,099	-3,123	-3,200	-3,280
Estimated Outlays	-2,854	-3,094	-3,099	-3,123	-3,200	-3,280

a. The 2002-2007 levels are CBO's baseline estimates of the amount of offsetting collections generated by FHA's single-family program and GNMA's single-family Mortgage-Backed Securities program.

BASIS OF ESTIMATE

CBO estimates that implementing the bill would cost \$213 million over the 2003-2007 period, assuming appropriation action consistent with the bill's proposed changes to FHA and GNMA programs. The estimated costs are for the provisions concerning down-payment simplification for FHA's mortgage guarantee program, and the fee charged by GNMA. These provisions are explained below.

Down-Payment Simplification

Currently, the down payment for FHA's single-family program is calculated using a formula established in 1996. Under this formula, the maximum mortgage amount that FHA could

insure is determined by a fixed percentage of the home value. The authority to use this formula is scheduled to expire on December 31, 2002, but this legislation would make its use permanent.

Based on information from FHA, CBO estimates that continuing the use of the current down-payment formula would slightly increase the cost of guaranteeing FHA loans because it would lead to a small increase in the loan-to-value (LTV) ratios for about 15 percent of the loans guaranteed each year after 2002. The LTV ratio indicates how much equity a borrower initially has in the home, and serves as a good predictor of the likelihood of default. On average, borrowers with less equity (that is, higher LTV ratios) have higher default rates than borrowers with more equity. We estimate that this provision would increase the cost of guaranteeing some loans, resulting in a cost of \$6 million in 2003 and \$40 million over the 2003-2007 period. The estimated changes in FHA's loan subsidy costs—which are treated as discretionary spending—would be recorded in each year as new loans are disbursed.

GNMA Guarantee Fee

GNMA is responsible for guaranteeing securities backed by pools of mortgages insured by the federal government. (These securities are known as mortgage-backed securities or MBS.) 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 these securities. Under current law, GNMA charges lenders or issuers an annual fee of 6 cents for every \$100 (6 basis points) of guaranteed mortgage-backed securities backed by single-family loans. Furthermore, a fee increase to 9 basis points is scheduled to take effect on October 1, 2004. Section 901 would repeal that fee increase. CBO estimates that eliminating the fee increase would increase the subsidy rate associated with the single-family MBS program and increase the demand for the program.

Based on information from GNMA, CBO estimates that lowering guarantee fees would reduce the subsidy for the single-family MBS program from negative 0.56 percent to negative 0.37 percent. (As with the FHA single-family program, GNMA guarantee fees for the mortgage-backed securities more than offset the costs of expected defaults, resulting in net collections from the MBS program.) Under the bill, CBO expects that extending the lower fee of 6 basis points would allow GNMA to remain competitive with other MBS programs and continue to guarantee more than \$100 billion worth of mortgage-backed securities, as it does under the current fee structure. Thus, while repealing the fee increase would result in a less profitable program, this loss would be partially offset by additional receipts stemming from an expected increase in demand for GNMA services of about 25 percent. On balance, CBO estimates that implementing this provision would cost \$56 million in 2005 and \$173 million over the 2005-2007 period.

PAY-AS-YOU-GO CONSIDERATIONS: None.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 2239 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 August 21, 2002, CBO transmitted a cost estimate for H.R. 3995, the Housing Affordability Act of 2002, as ordered reported by the House Committee on the Judiciary on July 23, 2002, and on September 10, 2002, CBO transmitted a cost estimate for H.R. 3995 as ordered reported by the House Committee on Financial Services on July 9, 2002. Both versions of H.R. 3995 include the provisions included in S. 2239, and our cost estimates are the same.

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