CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 29, 2008

H.R. 6694

FHA Seller-Financed Downpayment Reform and Risk-Based Pricing Authorization Act of 2008

As ordered reported by the House Committee on Financial Services on September 16, 2008

SUMMARY

H.R. 6694 would amend the Housing and Economic Recovery Act of 2008 (HERA) to provide exceptions to the prohibition that becomes effective on October 1, 2008, on seller contributions to homebuyers' downpayments. Seller contributions are a form of down-payment assistance to homebuyers that is provided by the seller (or a third party that is being reimbursed by the seller) toward the downpayment on a single-family loan insured by the Federal Housing Administration (FHA). Enacting this legislation would permit certain borrowers to receive such downpayment assistance and allow FHA to charge higher premiums for its mortgage insurance for such borrowers based on the credit score of the borrower.

Enacting this legislation also would eliminate the one-year moratorium, effective October 1, 2008, included in HERA, prohibiting FHA from implementing risk-based pricing of its mortgage insurance based on a borrower's credit score. The bill would authorize a "flexible risk-based" program for FHA that would permit risk-based pricing for borrowers with low credit scores. H.R. 6694 also would require FHA under certain circumstances to provide such borrowers with refunds of the premiums they paid.

CBO estimates that implementing H.R. 6694 would result in a net decrease in discretionary spending of $13 million over the 2009-2013 period, assuming enactment of appropriation laws necessary to implement FHA's single-family program and the Mortgage-Backed Securities (MBS) program of the Government National Mortgage Association (GNMA).

Enacting this legislation also would establish civil penalties (which are recorded in the budget as revenues) for certain violations related to real estate appraisals by interested parties in connection with the downpayment assistance program. CBO estimates that any increase

in revenues resulting from those civil penalties would not be significant. Enacting this bill would not affect direct spending.

H.R. 6694 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 H.R. 6694 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars					
	2009	2010	2011	2012	2013	2009-2013
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Cost of Seller-Financed Downpayment Assistance						
Estimated Authorization Level	0	*	*	*	*	*
Estimated Outlays	0	*	*	*	*	*
Additional GNMA Offsetting Collections						
Estimated Authorization Level	-13	-13	-13	-13	-13	-65
Estimated Outlays	-13	-13	-13	-13	-13	-65
Cost of Payment Incentives						
Estimated Authorization Level	0	13	13	13	13	52
Estimated Outlays	0	13	13	13	13	52
Total Changes						
Estimated Authorization Level	-13	0	0	0	0	-13
Estimated Outlays	-13	0	0	0	0	-13

Note: GNMA = Government National Mortgage Association; * = costs or savings of less than $500,000.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted near the beginning of fiscal year 2009.

Seller-Financed Downpayment Program

Under this legislation, a borrower would be permitted to use seller-financed assistance towards a downpayment if the borrower has a FICO[1] score of at least 620. In addition, FHA would be permitted to charge an up-front premium (a fee applied to the loan's value) and annual premium (a fee applied to the loan's outstanding balance) at levels that correspond to a borrower's risk, within certain limits.

Budgeting procedures for federal credit programs require that funds must be appropriated in advance to cover the estimated subsidy cost of loan guarantees on a present-value basis. Based on information from the Office of Management and Budget (OMB), CBO assumes that FHA would charge premiums that would result in an average subsidy rate near zero. Thus, CBO estimates that this provision would result in a negligible cost or savings of less than $500,000 a year over the 2009-2013 period.

Starting in 2010, this legislation also would permit borrowers with FICO scores of less than 620 to receive an FHA guarantee, but only if the Secretary of Housing and Urban Development certifies that such loans could be insured without the need for an appropriation to cover any credit subsidy costs. Based on information from OMB, however, CBO estimates that the subsidy rate for such loans would likely exceed zero. Therefore, we estimate that this provision would result in no additional loan guarantees over the 2009-2013 period.

GNMA Savings

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 the value of the fees collected by GNMA is estimated to exceed the cost of loan defaults in each year, the Administration

1. FICO scores are derived from models developed by the Fair Isaac Corporation and are used by lenders and others to assess the credit risk of a prospective borrower.

estimates that the GNMA MBS program will have a subsidy rate of -0.21 percent in 2009, resulting in the net collection of receipts to the federal government.

CBO estimates that most of the new loan guarantees made under this legislation would be included in GNMA's MBS program and that FHA would insure an additional $6 billion in new loan guarantees annually as a result of changes to the seller-financed downpayment program. Thus, CBO estimates that implementing the MBS program under this legislation would result in about $65 million in additional offsetting collections (a credit against discretionary spending) over the 2009-2013 period, assuming appropriation action to establish a dollar limitation for the GNMA securities program.

Flexible Risk-Based Pricing and Payment Incentives

The bill also would authorize a program for FHA that would permit risk-based pricing for certain borrowers. Under this provision, FHA could charge risk-based premiums to borrowers who have FICO scores of less than 600. This legislation also would require FHA to refund either all or a portion of the higher fees resulting from the borrower being subject to risk-based pricing if the borrower makes at least five years of timely mortgage payments. Such refunds would be made at the time the loan is paid off in full. (H.R. 6694 also would permit FHA to issue refunds to borrowers after three years of timely mortgage payments.)

Because of the one-year moratorium on risk-based pricing imposed by HERA, CBO has evaluated the cost of enacting this provision in 2009 with the assumption that FHA would charge the same premiums for every borrower within each product category in 2009. Based on information from FHA, CBO estimates that the average subsidy rate for single-family borrowers with low credit scores would be near zero under current law in 2009. It is unclear how FHA would implement risk-based pricing under this bill, and there are many options for doing so. However, because the average subsidy rate for the program in 2009 is estimated to be near zero, CBO expects that FHA would not exercise the authority provided in this legislation to charge higher rates for certain borrowers. Consequently, absent the higher premium charges, FHA would not provide any premium refunds. As a result, we estimate that this provision would have no budgetary effect in 2009.

In subsequent years, CBO expects that FHA would implement risk-based pricing under current law for all types of borrowers with the intent to realize an average subsidy rate that is near zero. CBO does not expect that FHA would charge borrowers added premiums to account for the cost of potential premium refunds to borrowers after three-to-five years. Under that assumption, the requirement to provide refunds to certain borrowers would increase the initial subsidy costs of the loan guarantees.

CBO estimates that the borrowers of about $5 billion in FHA-guaranteed mortgages made annually would eventually be eligible for refunds under this provision. This estimate of loan volume assumes that FHA would initially insure about $15 billion in loans with FICO scores of at least 600. Furthermore, CBO assumes that of this $15 billion in loan guarantees, about 65 percent would not be eligible for refunds because we expect that after five years the borrower would have defaulted, prepaid the mortgage, or have been late on payments.

The cost of refunds would depend on the premiums set by FHA. The agency has not yet set premiums for 2010, but based on information from FHA, CBO estimates that the refund provision would increase subsidy costs for the affected loan guarantees by an average of 0.25 percent. Under the Federal Credit Reform Act, such costs require the appropriation of funds. By applying this average cost to the potential volume of loan guarantees that would be eligible for refunds, CBO estimates that appropriations of about $13 million would be required annually over the 2010-2013 period.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 6694 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

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