# MORTGAGE FINANCING

## FHA and Ginnie Mae Face Risk-Management Challenges

GAO Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-578T, a testimony before the Subcommittee on Transportation, Housing and Urban Development, and Related Agencies, Committee on Appropriations, House of Representatives

### Why GAO Did This Study

In recent years, two components of HUD—FHA and Ginnie Mae—have played a major role in the single-family mortgage market. FHA insures lenders against losses from mortgage defaults. Ginnie Mae guarantees the timely payment of principal and interest for securities backed by federally insured or guaranteed mortgages. Due partly to the contraction of other mortgage market segments, FHA's and Ginnie Mae's business volumes have risen sharply. This growth highlights the need for these entities to properly manage financial risks while meeting the housing needs of borrowers.

This testimony discusses (1) changes in the financial condition of FHA's insurance fund, the budgetary implications of these changes, and how FHA evaluates the fund's financial condition; (2) steps FHA has taken to assess and manage risks; and (3) steps Ginnie Mae has taken to manage risks and estimate costs and revenues.

This testimony draws from GAO reports on FHA's oversight capacity (GAO-12-15), the financial condition of FHA's insurance fund (GAO-10-827R), and Ginnie Mae's risk management (GAO-12-49). GAO also reviewed updated information on the fund's condition as of September 30, 2011.

### What GAO Recommends

GAO previously recommended that FHA and Ginnie Mae take additional steps to improve their risk management. FHA and Ginnie Mae agreed with these recommendations and said they had efforts under way to implement them.

View GAO-12-578T. For more information, contact Mathew J. Scirè at (202) 512-8678 or sciremj@gao.gov.

### What GAO Found

For the third consecutive year, the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) reported that the capital ratio for the Mutual Mortgage Insurance Fund—the ratio of the fund's economic value to insurance obligations—has not met the 2 percent statutory minimum. FHA cites declines in the fund's economic value due to higher-than-expected defaults, claims, and losses. At the same time, the other component of the ratio, insurance obligations, grew rapidly. The fund's condition also worsened from a budgetary perspective, with balances in the fund's capital reserve account reaching new lows. If the account were depleted, FHA would require more funds to help cover costs on insurance issued to date. FHA has indicated that it will narrowly avoid this scenario in fiscal year 2012. FHA enhanced methods for assessing the fund's financial condition but has not fully addressed GAO's 2010 recommendation for improving the reliability of its estimates. It relies on a single economic forecast, which does not fully account for variability in future house prices and interest rates. The approach GAO recommended would simulate numerous economic paths for house prices and interest rates would improve the reliability of its capital ratio estimates.

FHA has taken or plans steps to better assess and manage risk. It created a risk office in 2010 and hired a consultant to recommend best practices. FHA plans to establish committees to evaluate risks at enterprise-wide and programmatic levels. It began a quality control initiative for single-family housing, in which program and field offices assess and report on risks, and enhanced lender and appraiser reviews. While FHA's consultant recommended integrating risk assessments, the quality control and risk office activities currently remain separate efforts. Also, since 2009, the Office of Single Family Housing has not updated assessments annually in accordance with HUD guidance. Without integrated and updated risk assessments that identify emerging risks, FHA lacks assurance it has identified all its risks. GAO recommended integrating quality control and risk office activities and updating assessments annually.

GAO and others have identified limited staff, substantial reliance on contractors, and the need for modernized information systems as risks that the Government National Mortgage Association (Ginnie Mae) may face. Ginnie Mae has several planned initiatives to enhance its risk-management processes related to gaps in resources, contracts, and issuers, but these plans have not been fully implemented. It will be important for Ginnie Mae to complete these initiatives as soon as practicable to enhance its operations. Also, in developing inputs and procedures for the model used to forecast costs and revenues, the agency did not consider certain practices identified in guidance for preparing cost estimates of federal credit programs. Ginnie Mae has not developed estimates based on the best available data, performed sensitivity analyses to determine which assumptions have the greatest impact on the model, or documented why it used management assumptions rather than available data. By not fully implementing certain practices, which GAO believes represent sound internal controls for models, Ginnie Mae's model may not use critical data that could affect the agency's ability to provide well-informed budgetary cost estimates and financial statements. GAO recommended that Ginnie Mae adopt these practices.