November 18, 2019

At a Glance

H.R. 123, Alternative Data for Additional Credit FHA Pilot Program Reauthorization Act

As ordered reported by the House Committee on Financial Services on September 20, 2019

By Fiscal Year, Millions of Dollars	2020	2020-2024	2020-2029
Direct Spending (Outlays)	0	0	0
Revenues	0	0	0
Increase or Decrease (-) in the Deficit	0	0	0
Spending Subject to Appropriation (Outlays)	2	-10	not estimated

Statutory pay-as-you-go procedures apply?	No	**Mandate Effects**	
Increases on-budget deficits in any of the four consecutive 10-year periods beginning in 2030?	No	Contains intergovernmental mandate?	No
		Contains private-sector mandate?	No

The bill would

- Authorize appropriations for the Federal Housing Administration (FHA) to create a pilot program for a credit-scoring system using alternative data
- Permit FHA to insure mortgages for homebuyers who meet credit score requirements that are based on that alternative data

Estimated budgetary effects would primarily stem from

- Spending funds authorized to be appropriated
- Increases in the premiums collected from mortgagors with FHA insurance

Detailed estimate begins on the next page.

See also *CBO's Cost Estimates Explained*, www.cbo.gov/publication/54437;
How CBO Prepares Cost Estimates, www.cbo.gov/publication/53519; and *Glossary*, www.cbo.gov/publication/42904.

Bill Summary

H.R. 123 would reauthorize a pilot program in the Federal Housing Administration (FHA) for five years, through 2024. That program would develop an automated system to calculate consumer credit scores using alternative information—such as performance on rental payments, utility bills, and insurance payments—that could be used by lenders to determine if a prospective borrower is eligible for an FHA-backed mortgage. The bill would authorize appropriations totaling $9 million over the 2020-2024 period for FHA to develop and implement the system for lenders. H.R. 123 also would require FHA to report to the Congress on the effectiveness of the pilot program.

Estimated Federal Cost

The estimated budgetary effect of H.R. 123 is shown in Table 1. The costs of the legislation fall within budget function 370 (commerce and housing credit).

Table 1.
Estimated Changes in Spending Subject to Appropriation Under H.R. 123

	By Fiscal Year, Millions of Dollars					
	2020	2021	2022	2023	2024	2020-2024
Pilot Program Administration						
Authorization	3	2	2	2	2	9
Estimated Outlays	2	2	2	2	2	9
FHA Insurance						
Estimated Authorization	0	-3	-5	-5	-5	-18
Estimated Outlays	0	-3	-5	-5	-5	-18
Total Changes						
Estimated Authorization	3	-1	-4	-4	-4	-9
Estimated Outlays	2	-1	-4	-4	-4	-10

Components may not sum to totals because of rounding; FHA = Federal Housing Administration.

Basis of Estimate

For this estimate, CBO assumes that H.R. 123 will be enacted near the end of 2019. CBO also assumes that future appropriation acts will authorize FHA to increase the amount of mortgage guarantees it provides by an amount sufficient to meet the increased volume of mortgage guarantees under the bill and that the authorized amounts will be appropriated for each fiscal year beginning in 2020.

Background

FHA, within the Department of Housing and Urban Development (HUD), provides mortgage insurance for the purchase, refinancing, and rehabilitation of single-family homes and charges up-front and annual premiums to mortgagors for that insurance. Those premiums are classified in the budget as offsetting collections, which reduce spending subject to appropriation.

To estimate the budgetary effects of such loan guarantees, CBO uses the methodology specified in the Federal Credit Reform Act of 1990 (FCRA) and estimates that the FHA mortgage insurance program will have a subsidy rate of -2.69 percent in 2020. A negative subsidy occurs when the net present value of all premiums charged for a loan guarantee is greater than the estimated default costs associated with that guarantee.[1]

Under current law, prospective borrowers must have a credit score of at least 500 (on a scale of 300 to 850) to be eligible for an FHA-insured mortgage. Such credit scores are typically calculated using the credit records maintained by the three nationwide credit-reporting agencies: Equifax, Experian, and TransUnion. According to the Consumer Financial Protection Bureau (CFPB), in 2010, about 11 percent of adults in the United States had no such credit records and about 8 percent had credit records lacking sufficient information to calculate a credit score.[2]

For prospective borrowers who lack sufficient credit histories to calculate a credit score, lenders may assess creditworthiness through alternative means, including their performance on rental payments; utility, phone, and cable television bills; and insurance or tuition payments. HUD permits lenders that originate FHA-insured mortgages to establish a borrower’s credit history through such alternative means and has provided guidance to lenders on how to evaluate nontraditional credit histories. Although some lenders have developed statistical scoring methods to determine borrowers’ creditworthiness based on such data, other lenders rely on the judgment of their staff to make those determinations on a case-by-case basis.

Spending Subject to Appropriation

CBO estimates that implementing H.R. 123 would reduce net spending subject to appropriation by $10 million over the 2020-2024 period.

Pilot Program Administration. H.R. 123 would authorize the appropriation of $9 million over the 2020-2024 period for FHA to administer a pilot program to create and implement an automated system for FHA lenders to calculate credit scores using information from alternative data sources. Assuming appropriation of the authorized amounts, CBO estimates that implementing that section of the bill would cost $9 million over the 2020-2024 period.

1. A present value expresses a flow of past and future income or payments as a single amount received or paid at a specific time. The value depends on the rate of interest, known as the discount rate, used to translate past and future cash flows into current dollars at that time. Under FCRA, projected future cash flows are discounted to the present using interest rates on Treasury securities.

2. See Consumer Financial Protection Bureau, Office of Research, *Data Point: Credit Invisibles* (May 2015), https://go.usa.gov/xp3F8.

FHA Insurance. Under the bill, FHA would be required to develop a credit-scoring system and to make it available to FHA lenders within one year of enactment.

Using information from the Federal Reserve on the number of applicants who were denied a federally insured mortgage in 2016, the most recent year for which data are available, and information from the 2015 CFPB report, CBO estimates that over the 2021-2024 period about 6,000 additional applicants could be deemed eligible for an FHA loan if lenders used an automated system that analyzes alternative information to calculate credit scores.

However, because H.R. 123 would allow FHA to determine the scope of the pilot program and how to implement it, CBO expects that the pilot program would be restricted to lenders and prospective borrowers that meet other qualifications and agree to participate. Accordingly, CBO estimates that about 3,000 borrowers (or half of the potential additional borrowers) would receive such a loan under H.R. 123 over the 2020-2024 period. CBO estimates that those borrowers would increase total FHA loan volume over that period by $700 million (or less than 0.1 percent of the estimated $1.2 trillion in total FHA volume over that period).

HUD currently allows lenders to provide FHA-backed loans to borrowers whose credit scores are determined using alternative methods and has provided guidance to lenders on how to evaluate prospective borrowers with nontraditional credit histories. Furthermore, if HUD determined that providing loans to prospective borrowers whose credit scores were calculated using such alternative methods would increase credit risk in the program, it could modify the fees it charges to those borrowers to offset any such risk. Accordingly, CBO estimates that the average subsidy rate for the overall FHA program would remain unchanged under H.R. 123 because we expect that new borrowers would be held to the same creditworthiness requirements as under current law. Therefore, taking into account the estimated increase in volume of FHA-insured mortgages and the negative subsidy rate on those mortgages, CBO estimates that implementing H.R. 123 would increase discretionary offsetting collections (and thus decrease discretionary costs) from the FHA mortgage insurance program by about $18 million over the 2020-2024 period.

Alternative Budgetary Treatment

The estimated cost of H.R. 123 depends on the method used to calculate the subsidy rate for mortgages insured by FHA. Under current law, the budgetary effects of FHA's mortgage insurance program are measured in the budget according to the procedures established in FCRA. However, as required by S. Con. Res. 71, the Concurrent Resolution on the Budget for Fiscal Year 2018, CBO also has prepared a cost estimate for H.R. 123 using a fair-value approach to estimating the budgetary effect on FHA.

The fair-value approach is an alternative to the approach specified in FCRA. Both approaches rely on the same projections of future cash flows for guarantee programs, and both account for the lifetime cost of the new guarantees made in a given year (including the expected cost of losses net of fees collected). Fair-value estimates differ from FCRA estimates by recognizing that the government's assumption of financial risk has a cost that exceeds the average amount of losses that would be expected from defaults. The higher financial risk is reflected in the higher fees private entities charge for similar guarantees on the basis of market prices. In practice, the main difference between FCRA and fair-value estimates is the discount rate used to calculate the present value of estimated future guarantee costs and receipts. Fair-value estimates use higher discount rates that incorporate a premium for market risk.

Using the fair-value approach, CBO estimates that the FHA mortgage insurance program will have a positive subsidy rate of 2.80 percent in 2020. If that rate were used to implement the mortgage guarantees the FHA program would have a cost rather than a savings.[3] Using the fair-value approach the estimated increase in FHA loan volume over the 2020-2024 period under H.R. 123 would increase the cost of FHA's mortgage guarantees by about $24 million. That estimate of $24 million does not include the administrative costs necessary to implement the pilot program, which CBO estimates would total $9 million over the 2020-2024 period (see Table 1). Therefore, CBO estimates that, on a fair-value basis, implementing H.R. 123 would cost a total of $33 million over the 2020-2024 period.

Pay-As-You-Go Considerations: None.

Increase in Long-Term Deficits: None.

Mandates: None.

Estimate Prepared By

Federal Costs: Robert Reese

Mandates: Rachel Austin

Estimate Reviewed By

Kim P. Cawley
Chief, Natural and Physical Resources Cost Estimates Unit

H. Samuel Papenfuss
Deputy Assistant Director for Budget Analysis

Theresa Gullo
Assistant Director for Budget Analysis

---

3. See Congressional Budget Office, *Fair-Value Estimates of the Cost of Federal Credit Programs in 2020* (May 2019), https://www.cbo.gov/publication/55278.