

# **Results of the FY2013 Independent Actuarial Assessment of the FHA Mutual Mortgage Insurance Fund**

December 13, 2013



# Summary

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1. This Administration has made **fundamental changes which have put FHA on a sustainable path** for fulfilling its dual mission of:
  - a. Aiding first time homebuyers and low-wealth households gain access to mortgage credit
  - b. Supporting the housing market during times of economic stress
  
2. The health of the **MMI Fund is improved**
  - a. Net worth grew **\$15 billion over last year's estimate**, rising from *negative* \$16.3 billion to *negative* \$1.3 billion
  - b. Capital reserve ratio rose from *negative* 1.44 percent to *negative* 0.11, a 1.33 percentage point improvement in just one year. It is now expected to **reach +2.0 percent in FY 2015—2 years faster than was predicted by the independent actuary last year**
  - c. Policy changes implemented since 2009 are reducing credit losses and increasing premium revenues for the Single Family forward portfolio; The HECM portfolio is now fully capitalized and is on an increasingly sustainable path moving forward
  - d. Ultimately, **policy changes have had dual impact of helping the Fund and reducing FHA's footprint in the market**
  
3. We need to **continue this momentum**
  - a. Aggressively minimize losses on legacy books
  - b. Refine policies currently in place to simultaneously increase access to credit and strengthen the Fund
  - c. Pursue further Congressional action to strengthen FHA long-term financial position

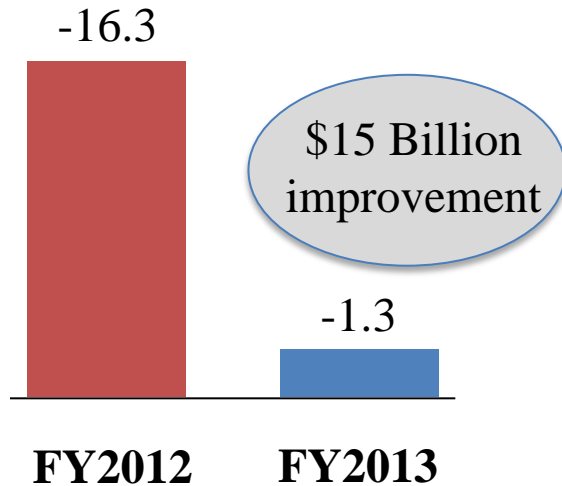
# Independent assessment shows \$15 billion improvement

## Official results of the independent actuary

FY 2012 vs. FY 2013 assessment

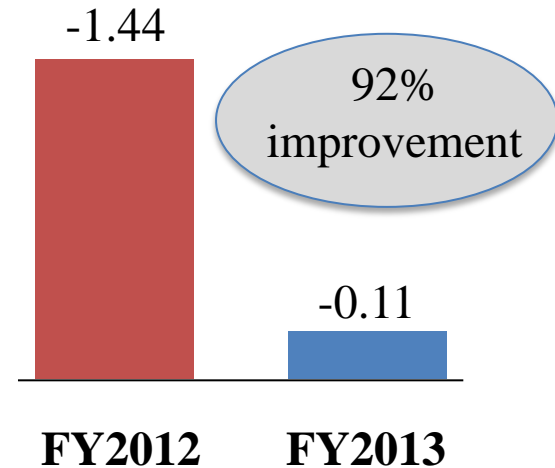
### Economic Net Worth

\$ Billions



### Capital ratio

Percent



# Actions resulting in a stronger Fund

## Actions taken since 2009...

### Programmatic changes to focus on core mission

- ✓ Eliminated costly seller-funded down-payment option
- ✓ Updated appraisal standards
- ✓ Added borrower protections to streamline refinance program
- ✓ Tightened down-payment/credit score requirements
- ✓ Introduced multiple risk controls in HECM program
- ✓ Expanded access to pre-foreclosure sales
- ✓ Completely revised condominium policy

### More robust risk management

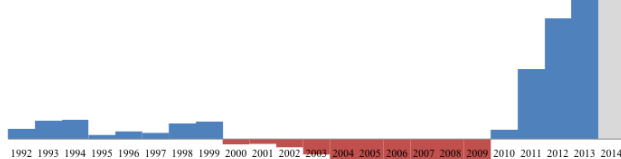
- ✓ Created Office of Risk Management
- ✓ Enhanced underwriting requirements
- ✓ Introduced affordability-based delinquency servicing guidelines
- ✓ Expanded use of REO alternatives through note sales and third-party sales
- ✓ Increased lender enforcement on underwriting and servicing standards
- ✓ Updated requirements for internal lender quality-control procedures

### Restructured pricing to match risk and build capital reserve

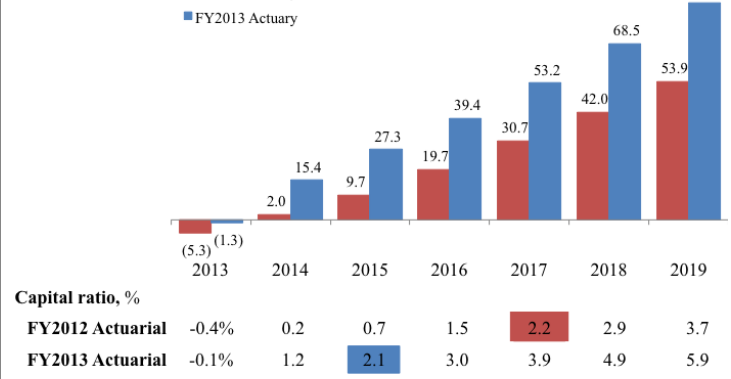
- ✓ More than doubled annual premium rate
- ✓ Extended term of annual premium charges to better match default risk exposure

## ...leading to better performance

Net Economic Value of Each Book-of-Business  
\$ Billions



Expected growth in economic net worth  
\$ Billion

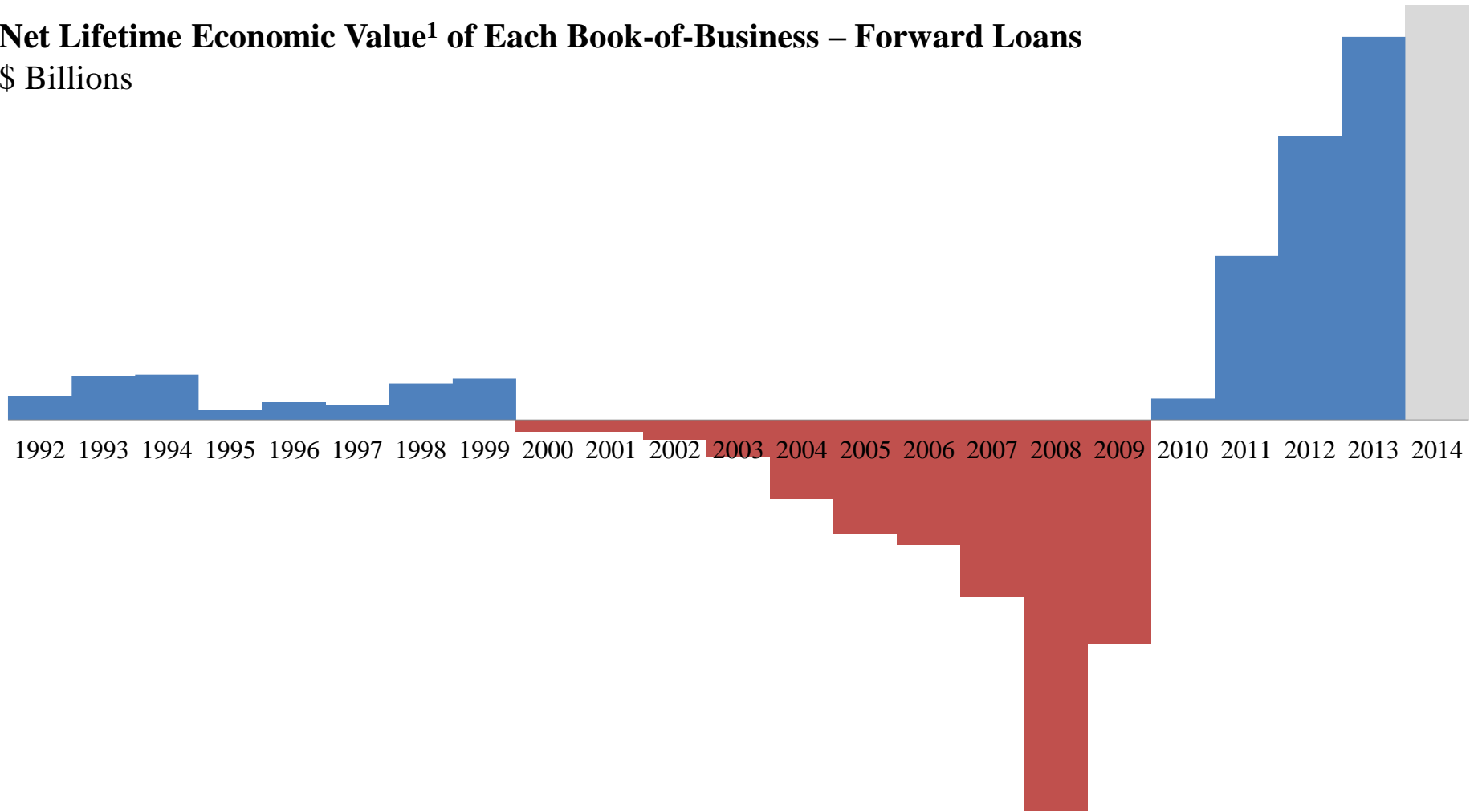


Capital ratio, %

	2013	2014	2015	2016	2017	2018	2019
FY2012 Actuarial	-0.4%	0.2	0.7	1.5	2.2	2.9	3.7
FY2013 Actuarial	-0.1%	1.2	2.1	3.0	3.9	4.9	5.9

# Newer Forward loans expected to perform significantly better than legacy portfolio

**Net Lifetime Economic Value<sup>1</sup> of Each Book-of-Business – Forward Loans**  
\$ Billions

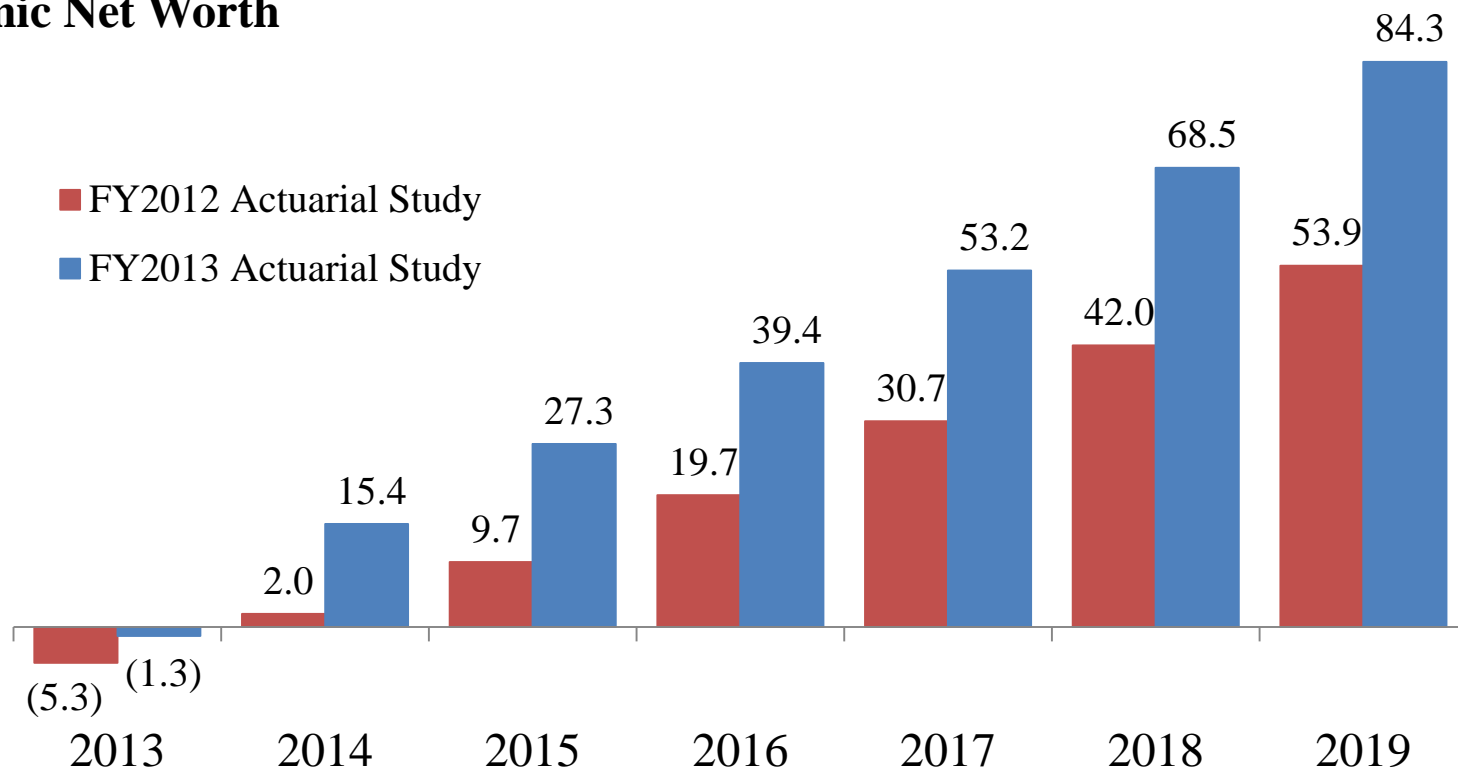


1. Net Lifetime Economic Value for each book-of-business is equal to the historical to-date performance of premiums and losses plus the independent actuarial projections of future performance of every loan endorsed in that book year. Lifetime economic value is today's assessment of the full lifetime value of all expected and realized premiums and losses.

# FY 2013 Independent actuarial estimate anticipates reaching 2% capital reserve ratio in FY2015

## Projected Economic Net Worth

\$ Billions



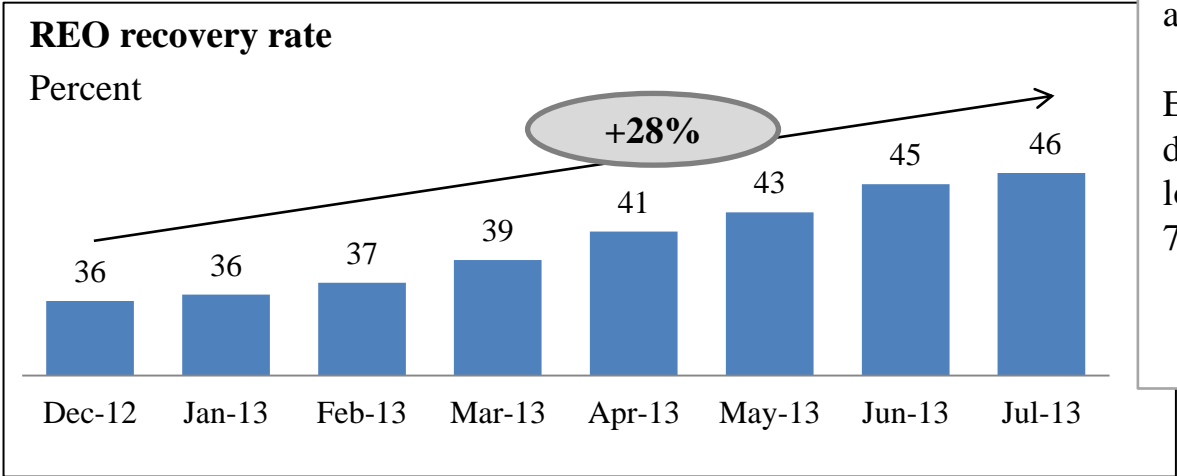
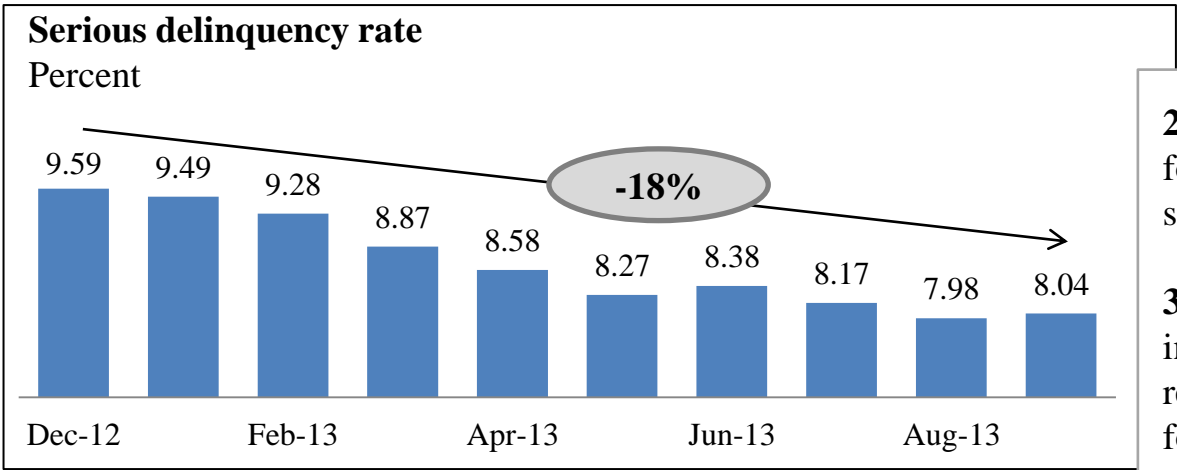
## Capital ratio, %

<b>FY2012 Projection</b>	-0.4%	0.2	0.7	1.5	2.2	2.9	3.7
<b>FY2013 Projection</b>	-0.1%	1.2	2.1	3.0	3.9	4.9	5.9

# Actuary's results are consistent with recent experience

## Implemented robust risk management

- Enhanced streamline refinance program
- Changed down-payment/credit score requirements
- Expanded access to pre-foreclosure sale program
- Created Office of Risk Management
- Enhanced underwriting requirements
- Introduced new loan modification waterfall
- Expanded use of REO alternative
- Increased enforcement for FHA lenders
- Updated quality control requirements



**20% decline** in foreclosure starts

**30% increase** in home retention and foreclosure avoidance activity

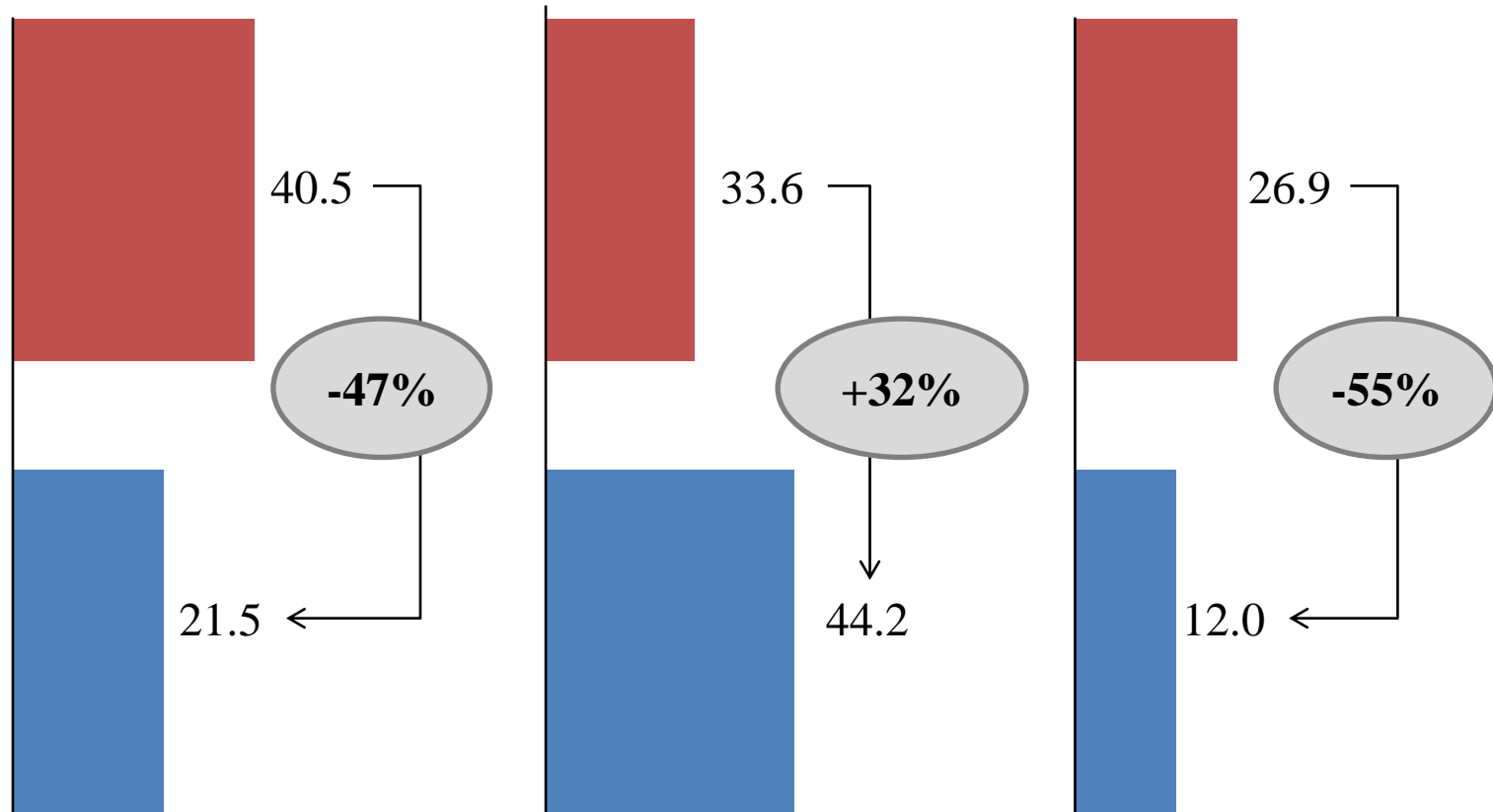
Early payment defaults at their lowest levels in 7 years

# FHA outperformed the actuarial loss forecast in FY 2013

**Claim UPB, \$ Billion      Recovery rate<sup>1</sup>, Percent      Claim loss<sup>2</sup>, \$ Billion**

**FY2012  
Independent  
Actuary's  
Forecast for  
FY2013  
Activity Year**

**Actual  
Performance  
in FY2013  
Activity Year**

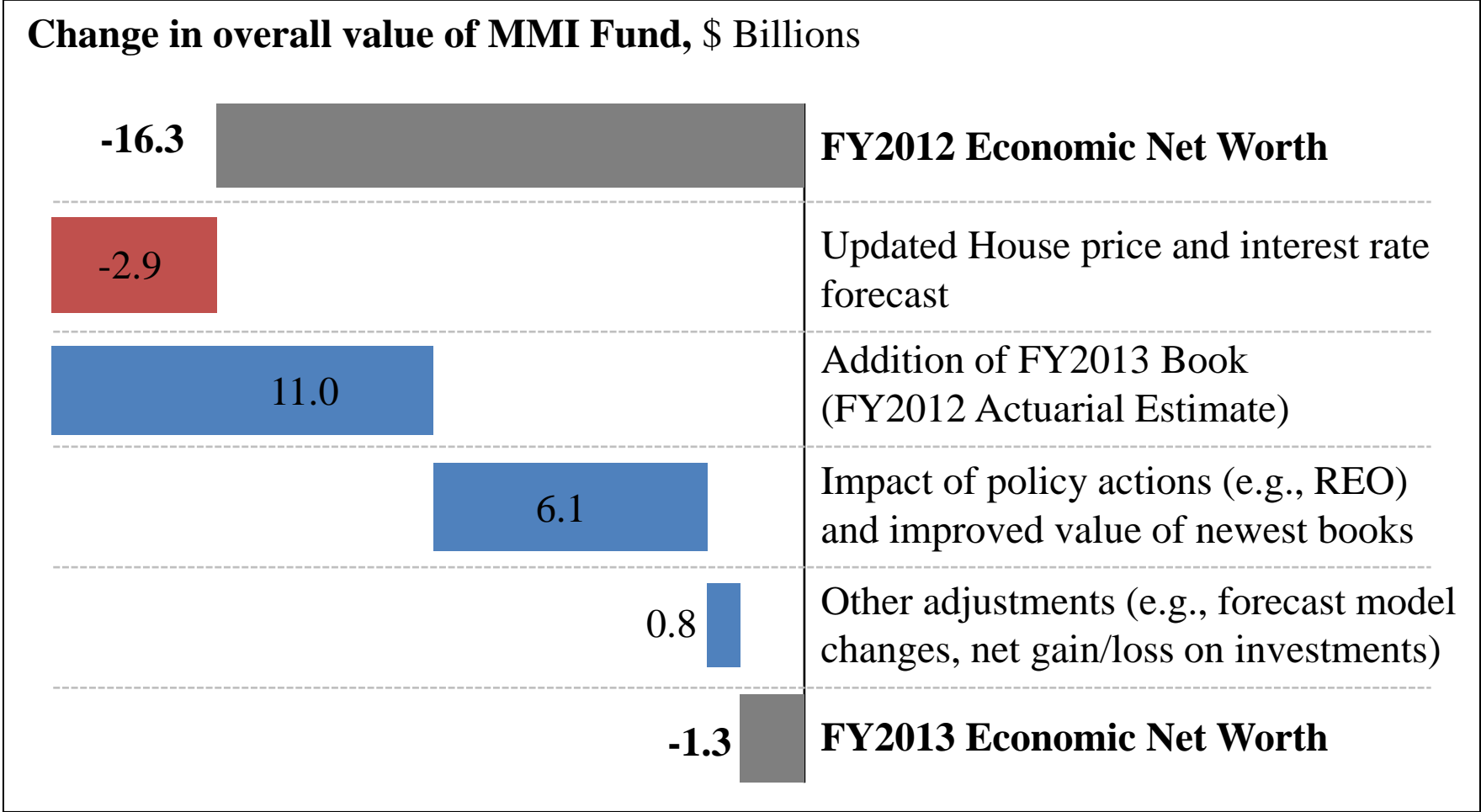


1. Percent of defaulted loan balance, net final recovery rate after claim and disposition.

2. Net loss recorded on loans with insurance claim



# Improvements driven by policy actions



Source: FY 2012 and FY 2013 Independent Actuarial Review of the FHA Mutual Mortgage Insurance Fund and U.S. Department of HUD/FHA

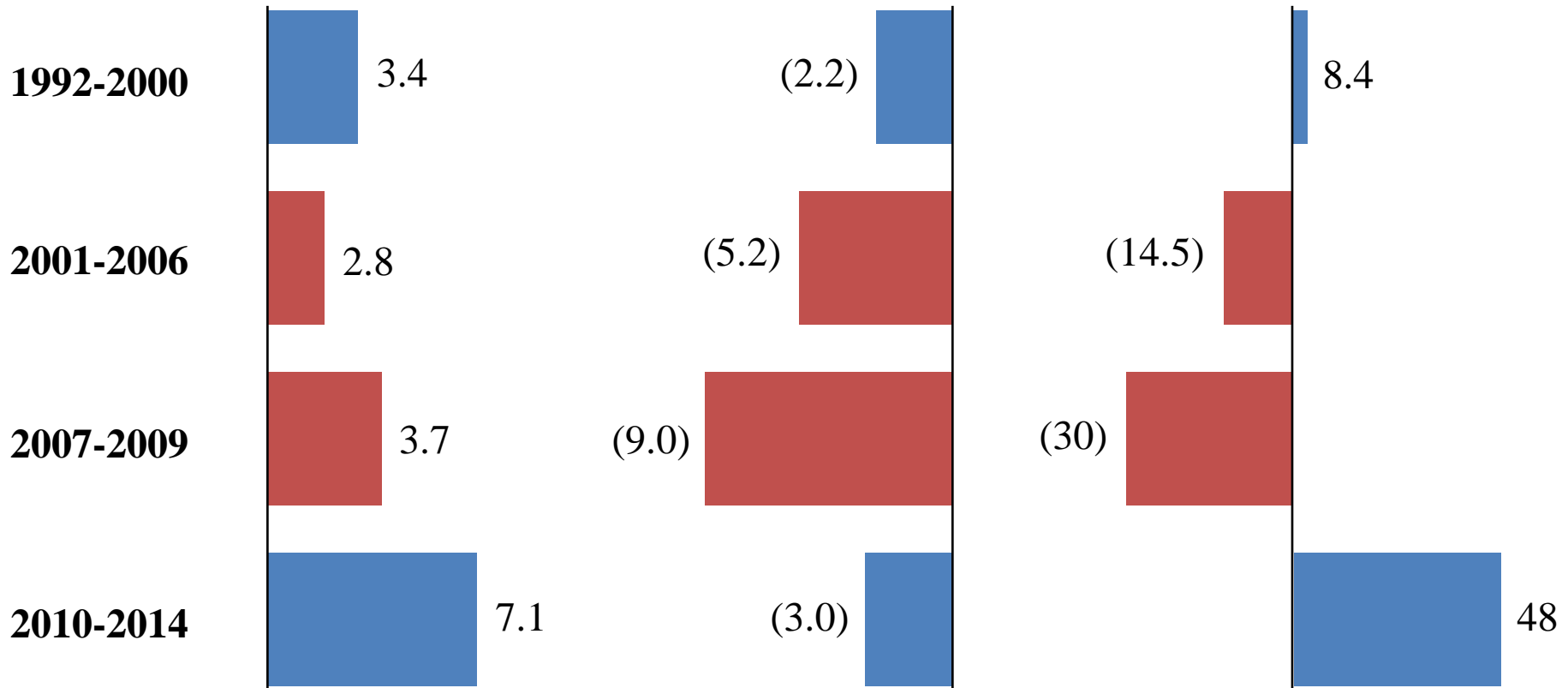
# Endorsements from 2007-2009 remain a challenge

**Forward  
Loans  
Book-of-  
Business**

**Premium revenue  
as share of  
endorsements, %**

**Credit Losses as  
share of  
endorsements, %**

**Net lifetime economic  
value<sup>1</sup>, \$ Billions**

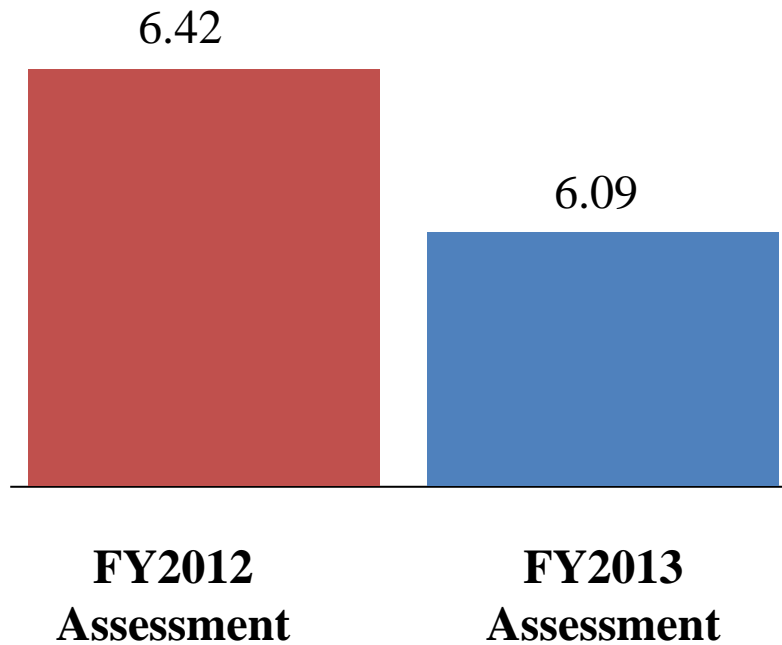


1. Based on historical to-date performance and independent actuarial projections of future performance. Net Economic Value is an assessment today of the lifetime value of each cohort to the Fund.

# The independent actuary now expects better performance in the forward loan portfolio

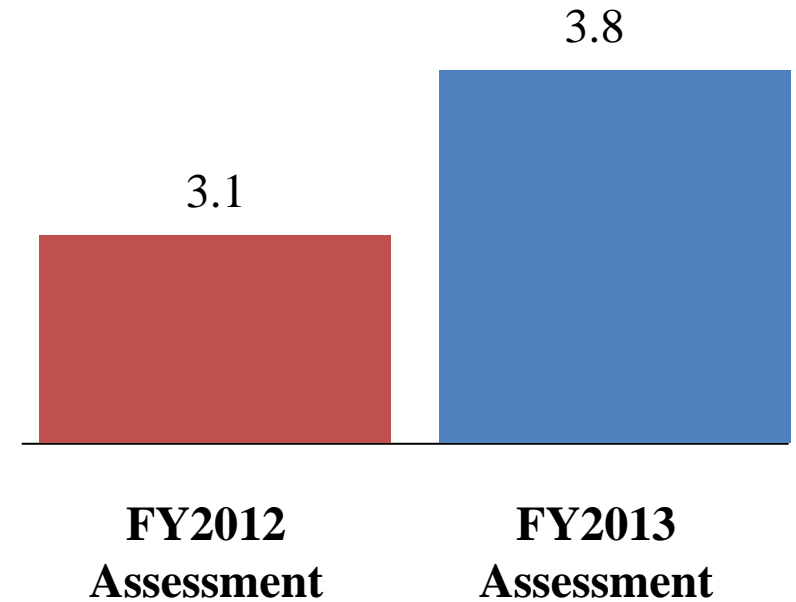
## Net credit losses – Forward Loans

Percent of IIF



## Premium revenue – Forward Loans

Percent of IIF



# Fully capitalized HECM program allows FHA to focus on long-term stability of new insurance

## Economic value of HECM portfolio in FY 2013, \$ Billion

Capital Resources as of 10/1/2012	2.5
Capital transferred from Forward loans	4.3
Mandatory Appropriation	1.7
Other capital adjustments <sup>1</sup>	0.7
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<b>1. Capital Resources as of 9/30/2013</b>	<b>9.1</b>
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FY2012 actuarial PV of Future Cash Flows	(7.6)
Improvements in PV of Future Cash Flows <sup>2</sup>	5.0
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<b>2. FY2013 actuarial PV of Future Cash Flows</b>	<b>(2.6)</b>
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<b>FY2013 Economic Net Worth (1 + 2)</b>	<b>6.5</b>

1. Net Gain from Investment, Net Insurance Income, Net Change in Value of Property Inventory, Net Change in Accounts Payable

2. Including improvements due to updates in macroeconomic forecasts (house price appreciation and interest rates)

Source: FY 2012 and FY 2013 Independent Actuarial Reviews of the FHA Mutual Mortgage Insurance Fund and U.S. Department of HUD/FHA

# Improvements confirmed by a second independent evaluation

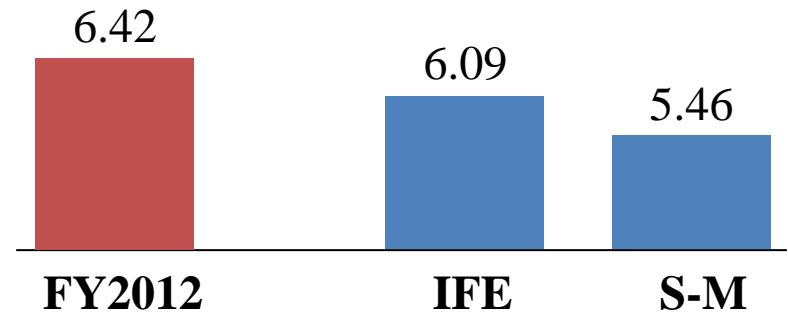
For FY 2013, FHA procured an independent contractor to conduct a separate but parallel evaluation of the Fund.

- This contractor, Summit Milliman (S-M) built a new model for this review, applying the same FHA data and independent economic assumptions used by the official actuary, Integrated Financial Engineering (IFE).
- Unlike IFE, the S-M process did not apply stochastic modeling to evaluate the portfolio nor has their model been independently validated.

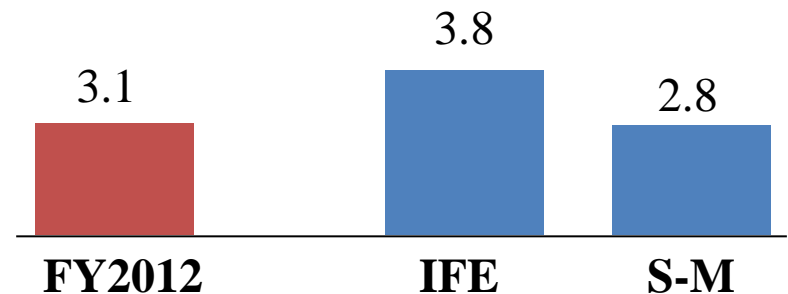
**S-M assessment found that the portfolio has experienced a year over year improvement in economic value of \$9 billion relative to prior estimates.**

## Forecast of Forwards Loan Portfolio

### Net Credit Losses, Percent of IIF



### Premium revenue, Percent of IIF

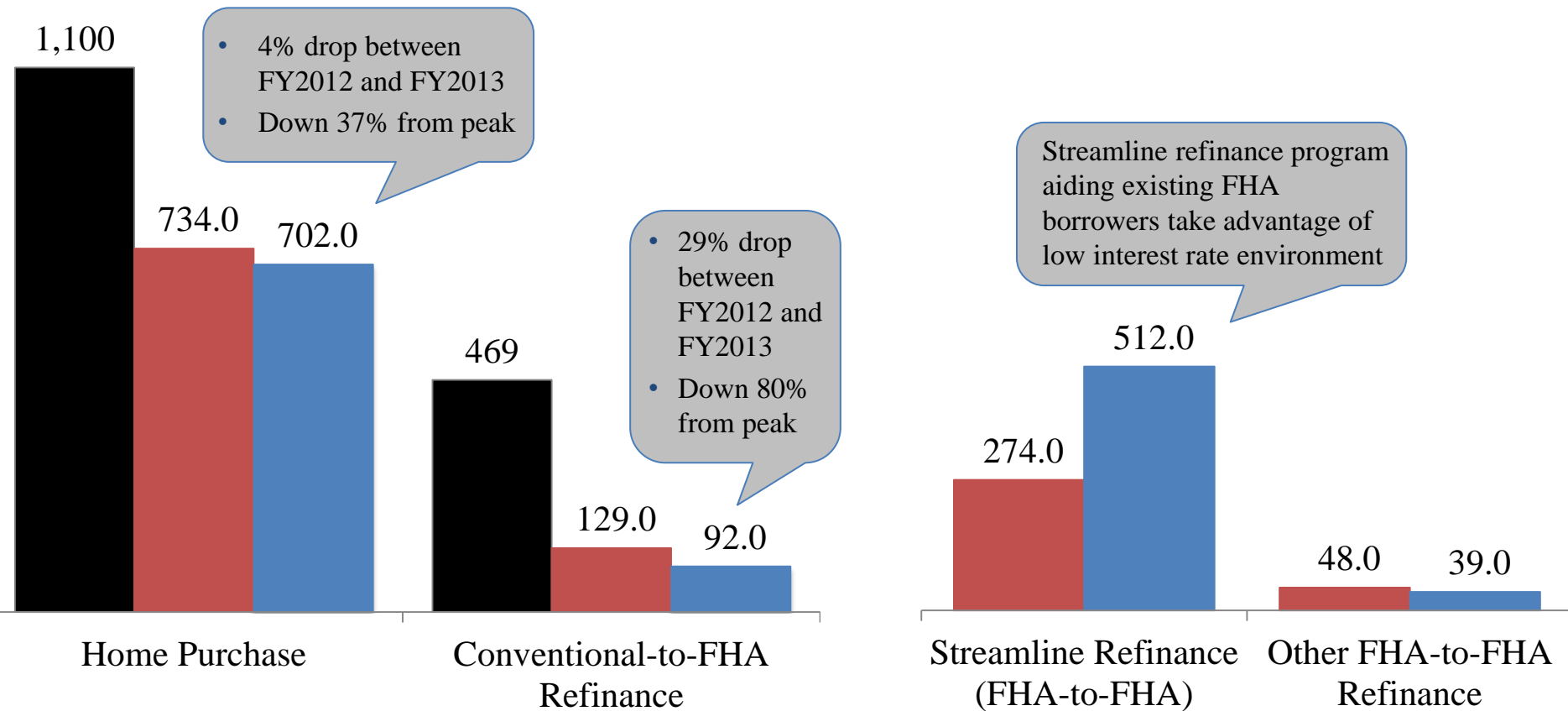


# FHA's footprint has receded

## Annual endorsement activity by product

Loan count, thousands

Peak year<sup>1</sup>  
 FY 2012  
 FY 2013



1. Purchase peak was FY2010, Conventional-to-FHA Refinance peak was FY2008

# Key initiatives to continue momentum and manage risk

**Continue to aggressively implement initiatives to minimize credit losses**

1. Optimize execution of REO alternatives
2. Further structural changes to HECM program

**Take actions that simultaneously increase access to credit and strengthen the Fund**

3. Enhance quality control and lender oversight
4. Launch Housing Counseling initiatives (e.g., incentives for counseling)

**Pursue congressional action to further strengthen FHA for the long run**

5. Authority to better manage lenders (i.e., indemnification authority, authority to terminate approval, revised compare ratio requirements)
6. Authority to re-direct servicing
7. Reduce barriers to more effective risk management (e.g., align human capital management authorities with financial regulators)

# Conclusion

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1. Throughout its history FHA has played a **dual role helping millions of American families own or refinance a home** and stepping in to **stabilize the housing market during economic crisis**
2. According to the independent actuary, **the health of the MMI Fund has improved by \$15 billion dollars when compared to last year.** The Fund's capital reserve ratio improved 92 percent and is expected to reach two percent in 2015
3. **Policy changes account for much of the improvement** in key performance metrics such as recovery rates
4. Many of these same **policy changes have helped to reduce FHA's footprint** in the market place
5. Going forward, FHA plans to continue to **aggressively pursue strategies that simultaneously reduce losses and enhance access** for its core population

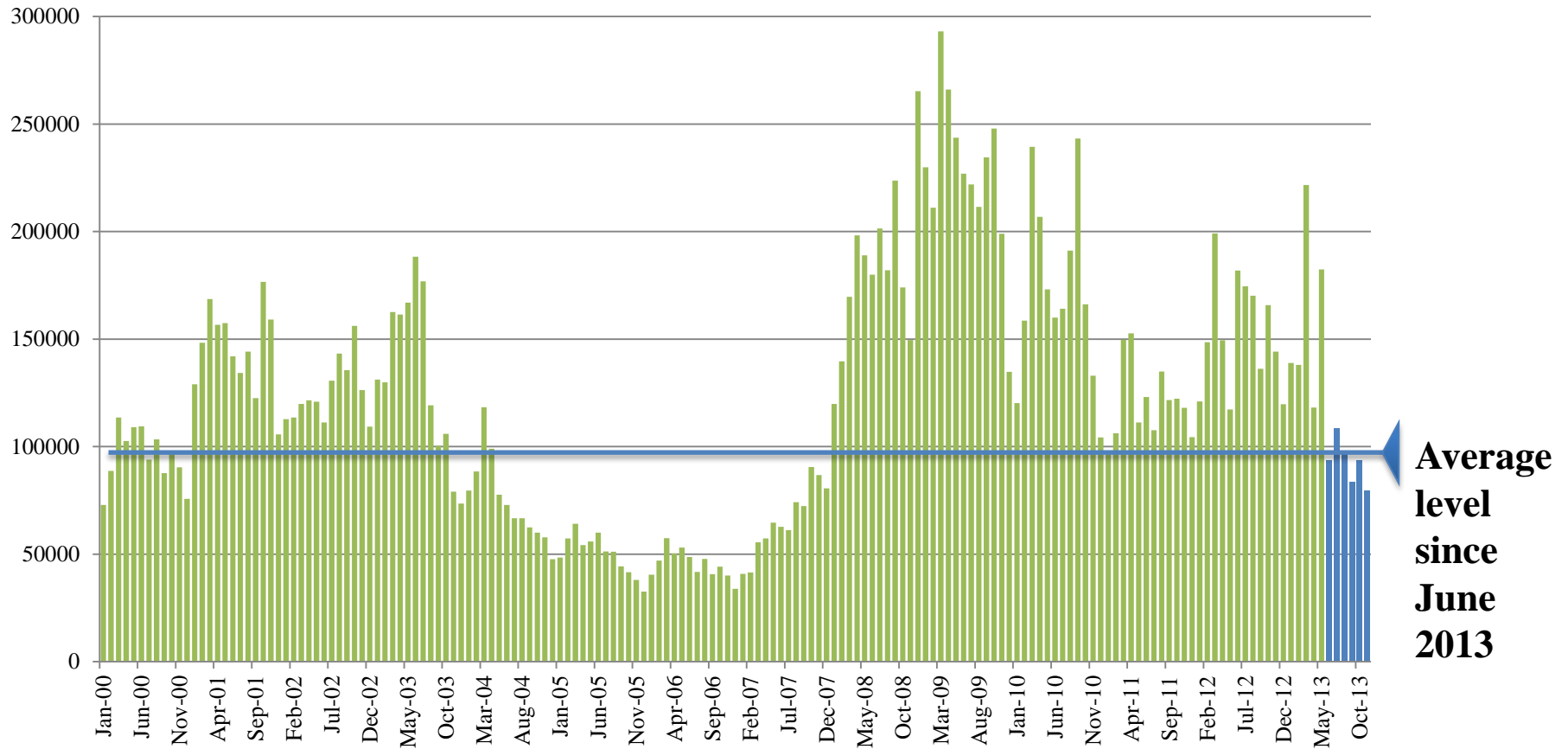


# **APPENDIX**

# FHA loan applications are back to traditional levels after an unprecedented housing cycle

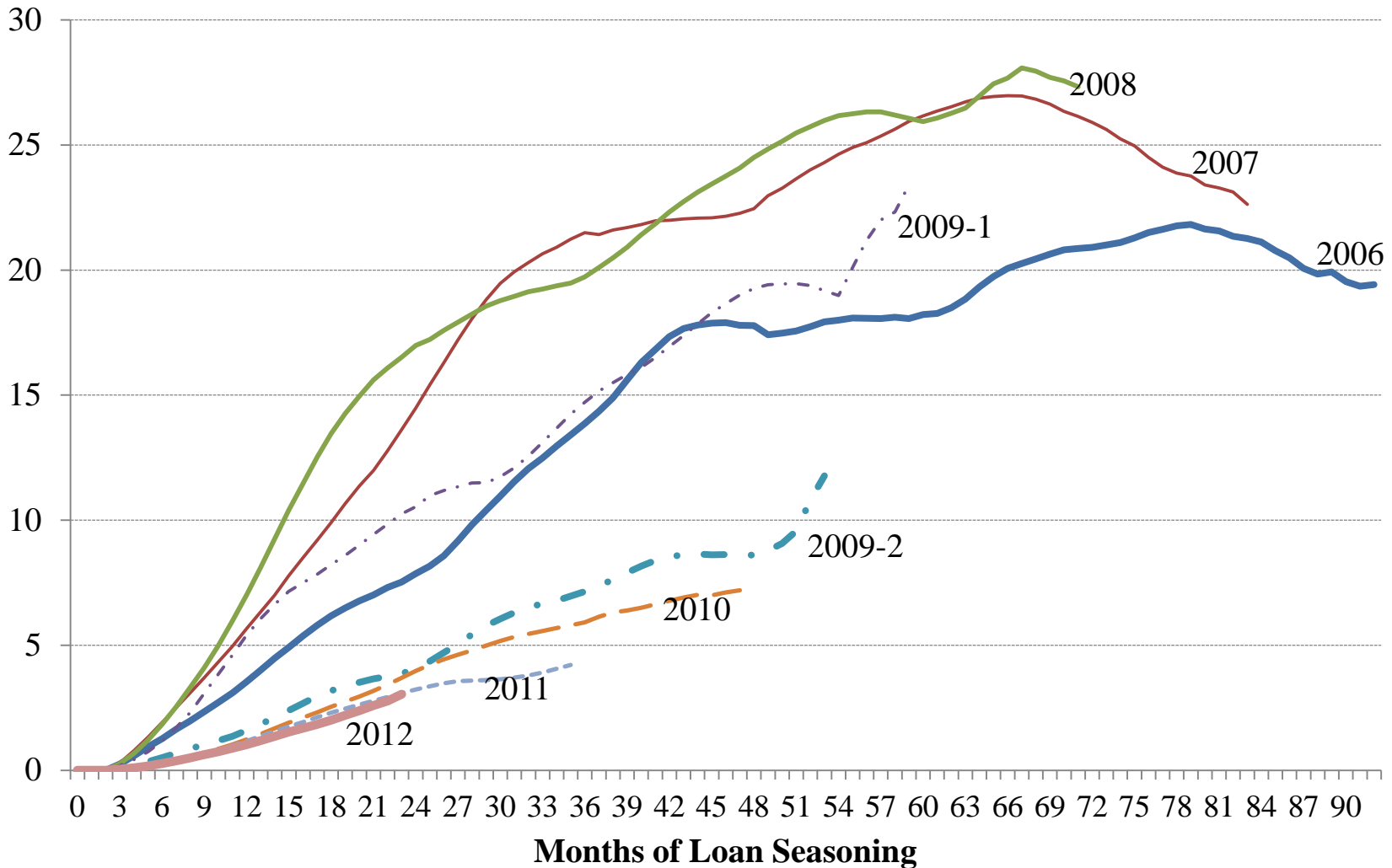
## Monthly Single-Family Forward Loan Application Activity

Loan Count

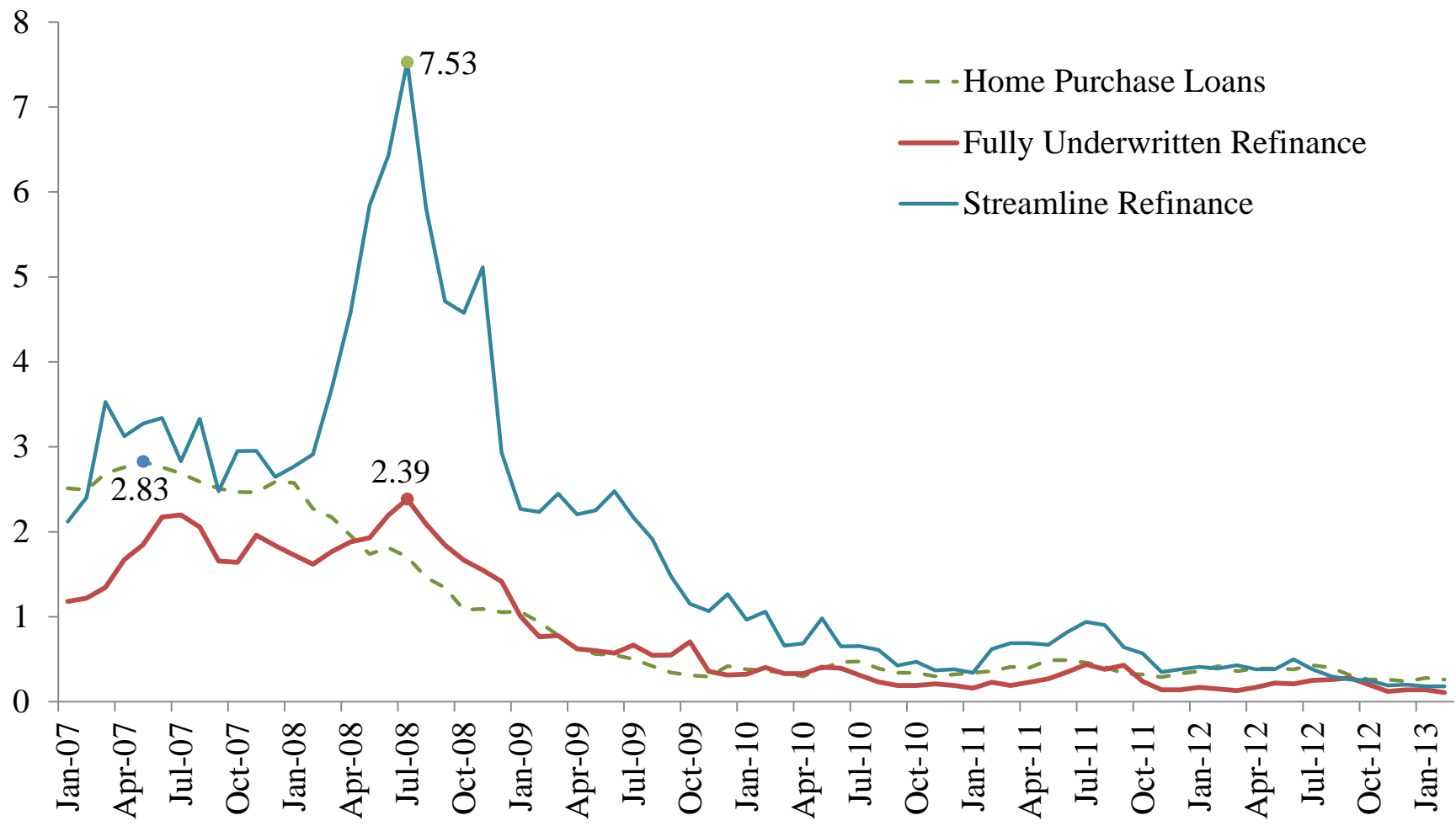


# Serious delinquency rates by loan origination vintage

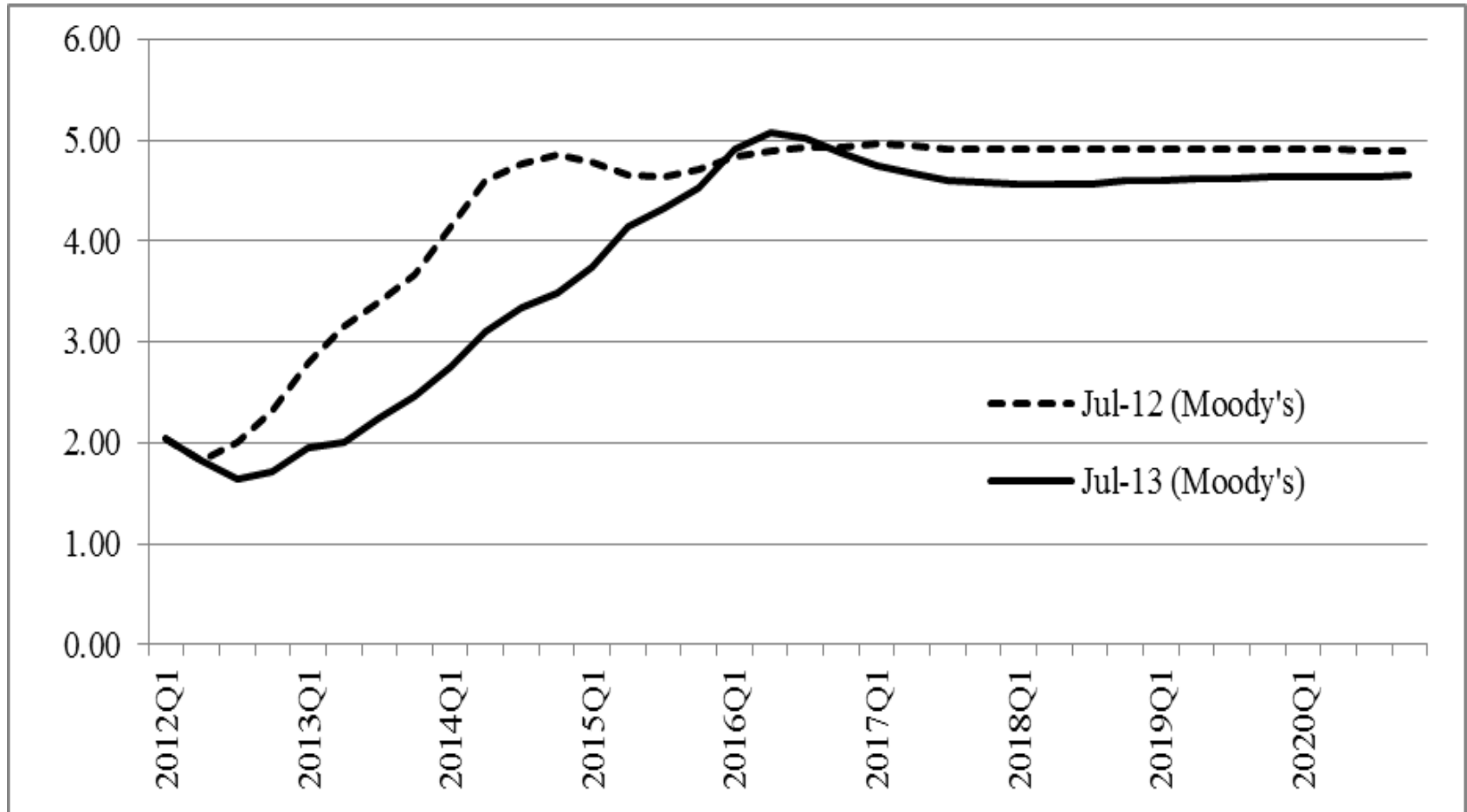
(percent of active loans, excluding streamline refinance)



# Early payment default rates by loan purpose and origination month (Percent)



# Moody's Analytics interest rate forecast used in actuarial projections (FY2012 vs. FY2013)



# Moody's Analytics house price appreciation forecast used in actuarial projections (FY2012 vs. FY2013)

