



U.S. Department of Housing and Urban Development

Financial Status of the FHA Mutual Mortgage Insurance Fund FY 2010

November 16, 2010

Federal Housing Administration





FHA Is playing a critical role in the housing and mortgage markets



FHA continues to **fulfill its mission of facilitating the recovery of the housing market** by serving as a responsible countercyclical source of liquidity.

In FY 2010, FHA:

- Served more than 1.75 million households by insuring \$319 billion in single-family mortgages. This volume was second only to FY 2009
- Enabled 882,000 families to become homeowners for the first time. This was more than one-third of all first-time buyers in the nation
- Enabled 556,000 families to refinance their mortgage at lower interest rates, saving \$140 per month on average
- Provided access to credit for close to 40 percent of purchase mortgages, including 60% of all African-American and Latino homebuyers
- Helped more than 450,000 families avoid foreclosure through loss mitigation



FHA is stronger today than last year



- Actual fund performance has improved on a number of metrics in FY 2010
- Even before last year's actuarial review, FHA management began instituting a sweeping series of policy changes to strengthen the fund. These policies have **improved loan quality, strengthened lender enforcement, and helped to protect future portfolio performance.**
- The quality of recent loans and the April premium rate increase contributed approximately **\$9 billion in economic value compared to last year's review**
- **Capital resources are at their highest level ever** and are \$5.5 billion greater than the independent actuary predicted last year. This year, FHA's total capital resources have increased by \$1.5 billion to \$33.3 billion
- Insurance claim expenses are 21% lower than predicted in last year's report
- **Single family loan quality has improved dramatically**; the FY 2010 book has the best credit characteristics in FHA's history



Summary of the FY 2010 Independent Actuarial Studies



- Despite adopting more conservative economic forecasts and model changes this year, **the MMI Fund capital ratio remains positive at 0.50%**
- The economic value of the MMI fund has increased by \$1 billion to \$4.7 billion, mostly driven by strong 2010 loans
- Without any additional policy actions, and incorporating the more conservative economic forecasts, the capital ratio is expected to be 1.99% in 2014 and **exceed the 2% statutory requirement by 2015**
- The capital ratio is one measure of FHA's future financial health but has limitations as it assumes a wind-down scenario in which FHA stops insuring new loans and underestimates FHA's future economic health
- Significant losses are expected on loans made before 2009. However, recent loans have positive economic value and **future business is projected to earn net revenue to continue rebuilding the capital reserves**. FY 2010 and FY 2011 alone are expected to contribute \$10.6 billion in value to the MMI Fund
- If the economy were to suffer another significant downturn, recovery of the capital ratio will be delayed. However, even in the actuaries' worst case stress test scenario, the **capital resources remain self-sufficient**, an improvement over last year's assessment



Contents



- **2010 Actuarial Review findings and financial status**
 - The strength of new and recent insurance
 - Responsible steps taken by FHA
 - Moving forward
 - Appendix



FHA's total capital resources increased \$1.5 billion to \$33.3 billion



The **Capital Resources** are liquid assets available to the MMI Fund to pay claim expenses.

They consist of two accounts:

- The **Financing Account**, which is used to manage current business cash flows and which holds funds to pay forecasted (net) claim expenses on today's insured portfolio, for the next 30 years.
- The **Capital Reserve Account**, which holds secondary reserves that are available to pay any unexpected claim expenses.

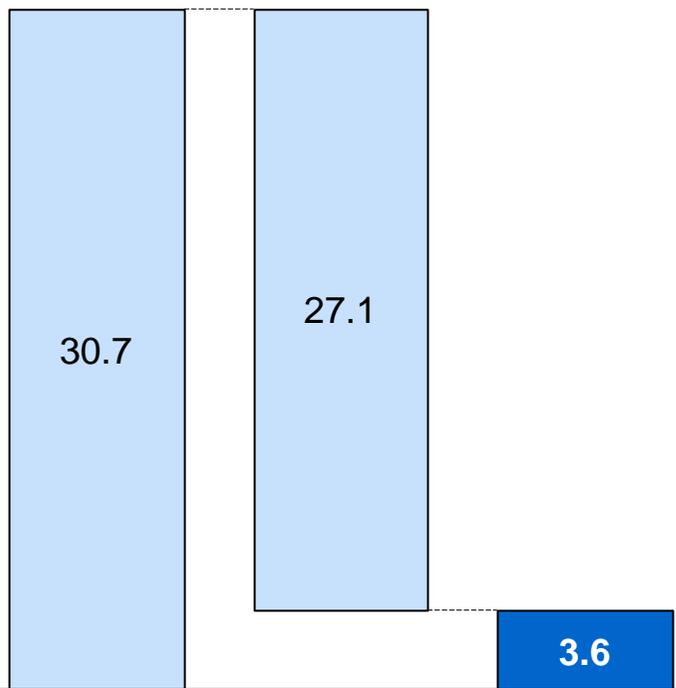


The estimated economic value of the MMI fund improved by more than \$1 billion in 2010



Estimates from the 2009 review for FY 2009

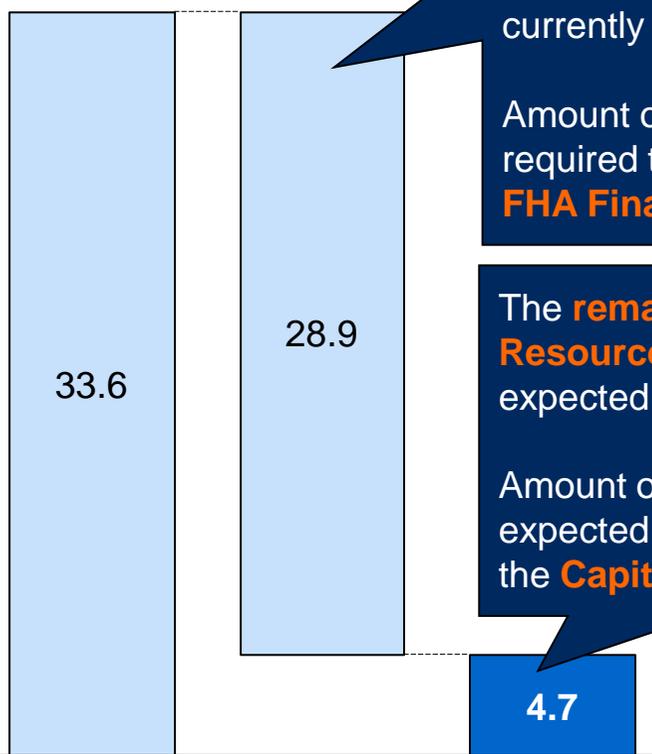
\$ Billions



Capital resources PV of future cash flows **Economic value**

Estimates from the 2010 review for FY 2010

\$ Billions



Capital resources PV of future cash flows **Economic value**

The **expected net cost** over the next 30 years of loans currently insured

Amount of Capital Resources required to be held in the **FHA Financing Account**

The **remaining Capital Resources** after subtracting expected costs

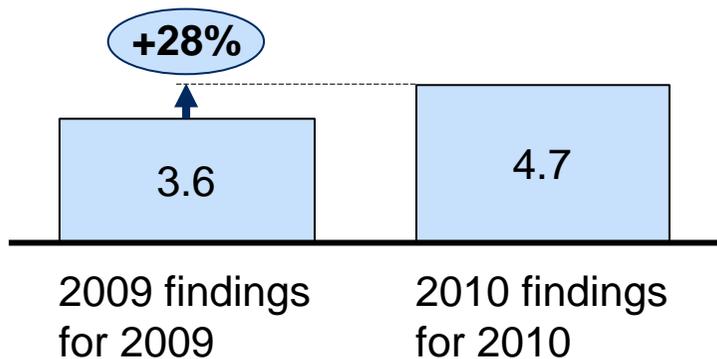
Amount of Capital Resources expected to be available in the **Capital Reserve**



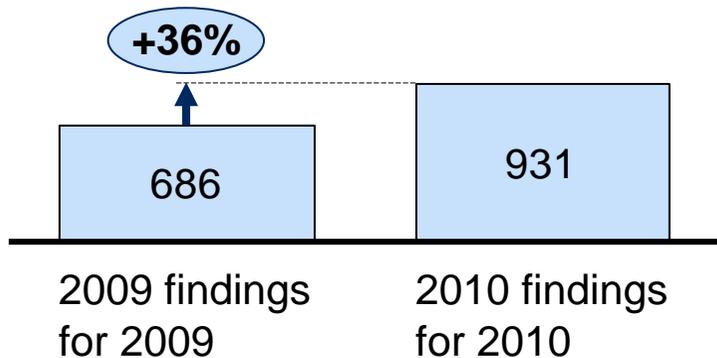
Both economic value and insurance in force increased this year, leading to a slightly lower capital ratio



Economic value USD Billions

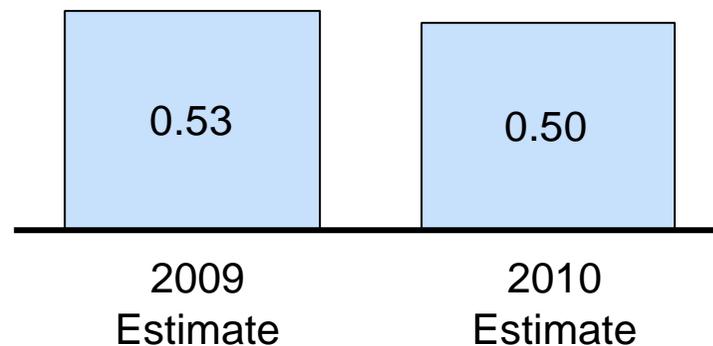


Amortized insurance in force (IIF) USD Billions



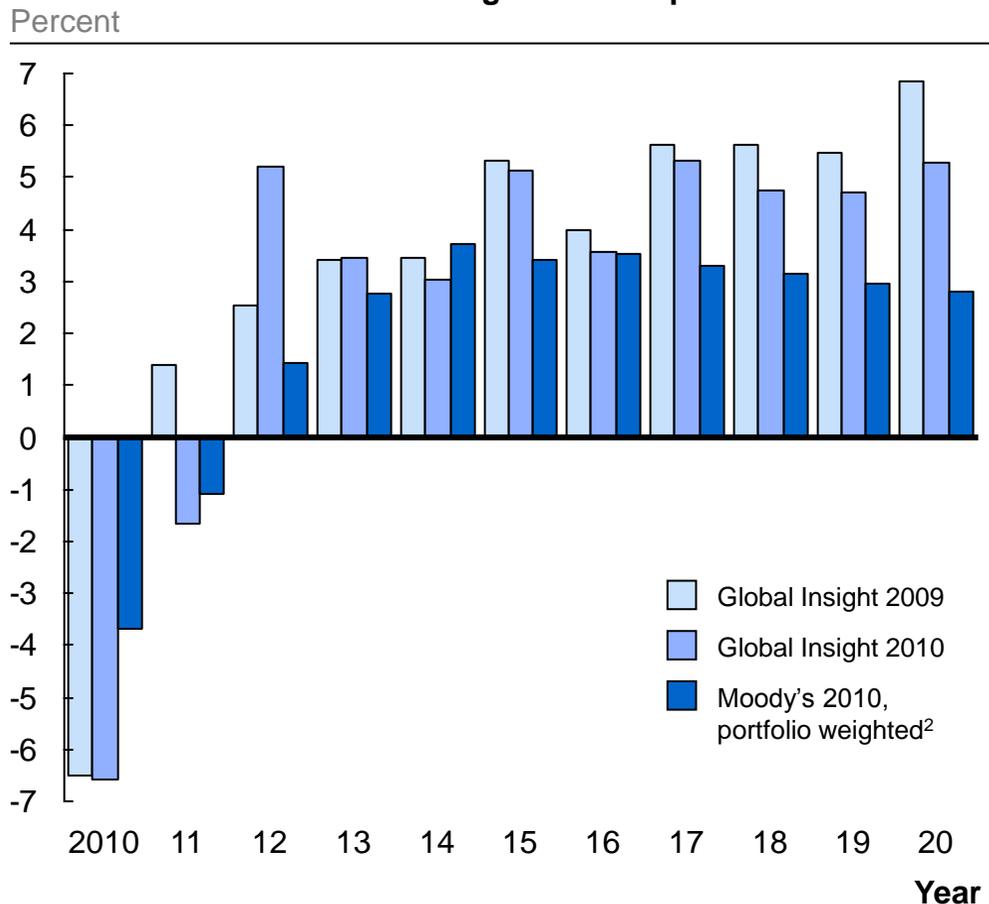
$$\frac{\text{Economic value}}{\text{Amortized IIF}} = \text{Capital ratio}$$

Capital ratio Percent



The economic value of the fund increased despite significantly more conservative economic forecasts

Forecasted annual rate of change of house prices¹



- The economic value and capital ratio are highly sensitive to house price forecasts
- The 2009 Actuarial Review used IHS Global Insight's July 2009 national house price forecast. This year, the independent actuary switched to Moody's Analytics. Moody's provides both metro-level forecasts and a range of alternative economic scenarios.
- Moody's forecasts for future house price growth are more conservative than Global Insight's. When applied to the FHA portfolio, Moody's forecasts result in long-term growth rates of less than 3% per year compared to 5% using Global Insight's forecasts. This change reduced the economic value of SF loans by **\$4.6 billion**
- In addition, this change of house price forecasts reduced the economic value of HECM loans by **\$3.9 billion**

1 FHFA all transactions House Price Index at the national level

2 Weighted by the Single Family portfolio, which is 95% of the MMI Fund by loan volume



The increase in economic value is primarily due to strong 2010 loans, but is kept in check by more conservative house price forecasts



	Change in EV (\$, Billions)	EV (\$, Billions)
FY 2009 Estimate of Economic Value		3.6
FY 2009 Projection of FY 2010 Economic Value		9.8
Changes noted in the FY 2010 actuarial study		
Better credit quality and early performance of FY 2009 and FY 2010 Loans	+8.1	
SF premium rate increase in April	+0.6	
More conservative house price forecast	-8.5	
Model improvements	-3.5	
All other changes	-1.8	
FY 2010 Estimate of Economic Value		4.7

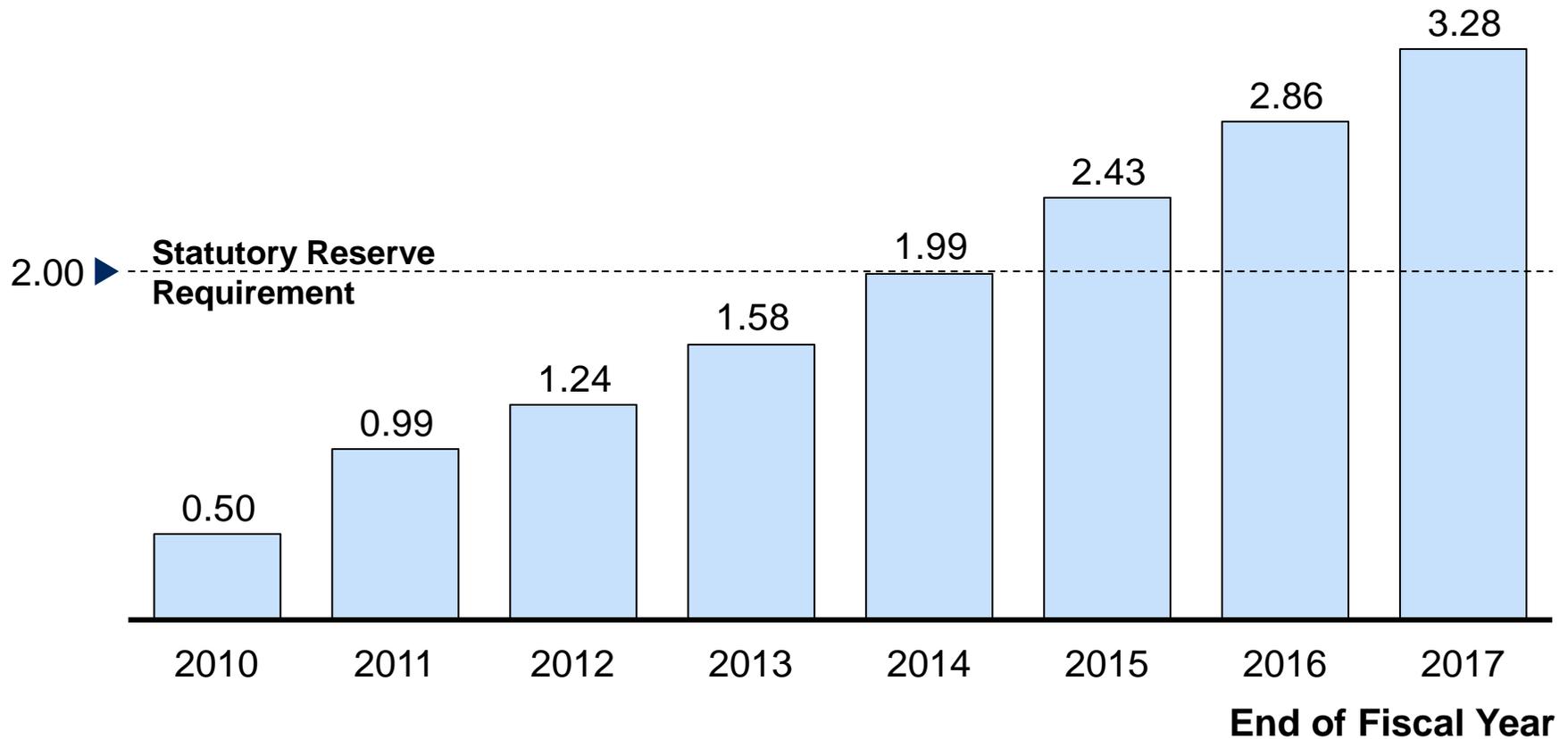


Without additional policy changes to future business, the capital ratio is projected to exceed 2% by 2015



Capital Ratio

Percent

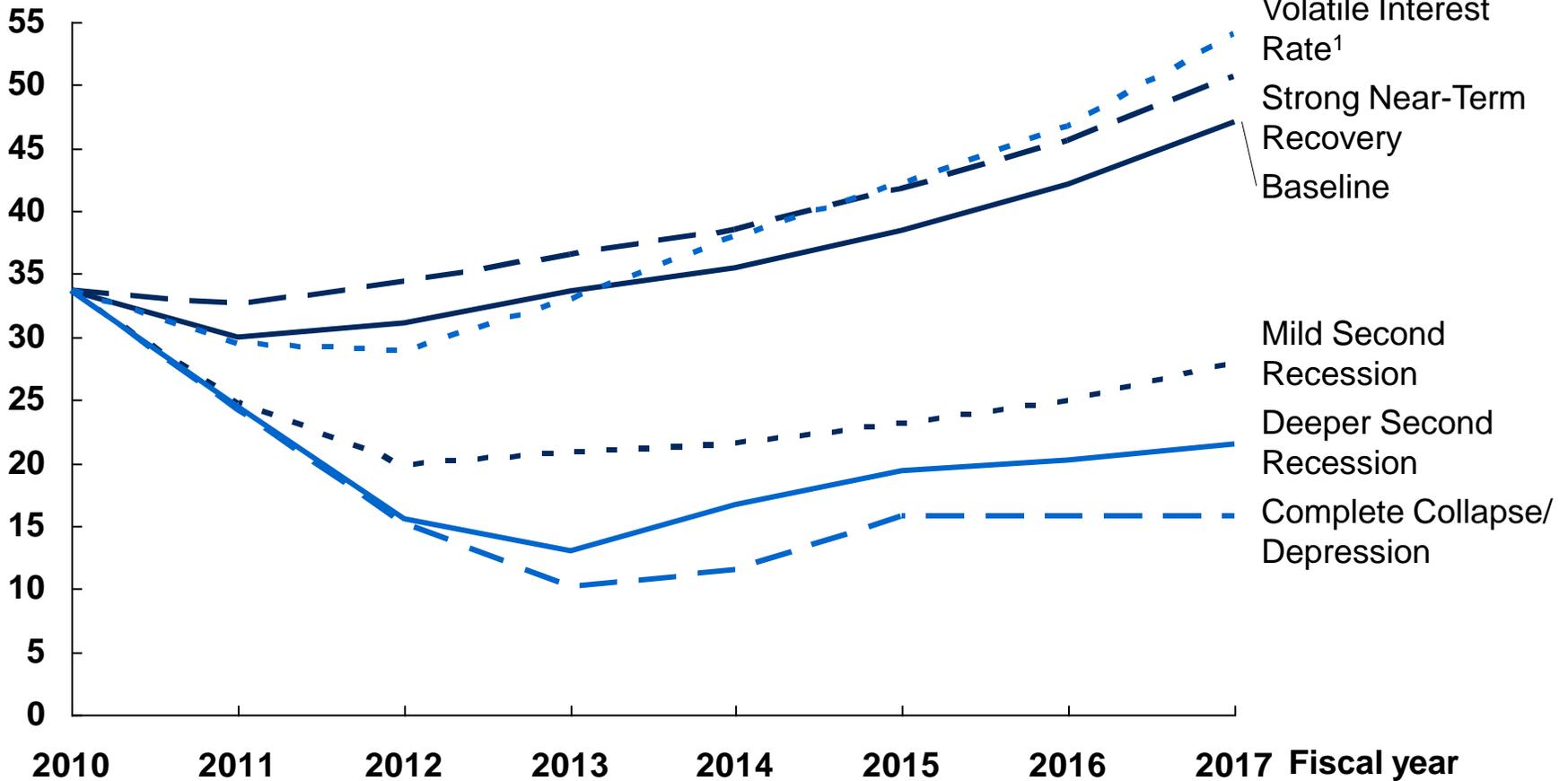




Capital resources will remain above \$9.9 billion even in the Depression scenario



Capital Resources (continuing business)
USD Billions



¹ The volatile interest rate scenario is only applied to SF loans while HECM retains base case assumptions

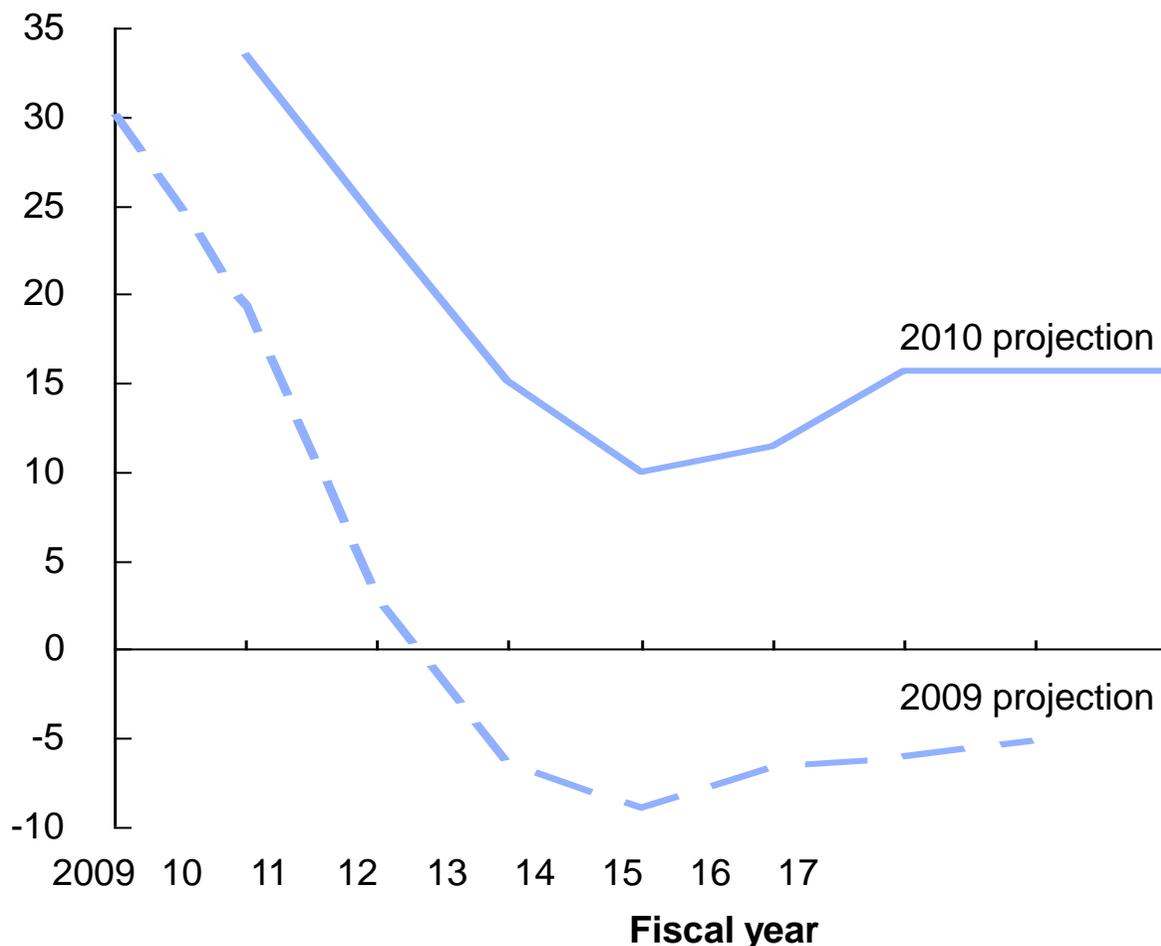


2010 projections for capital resources in a Depression scenario are substantially better than 2009 projections; they are never expected to be negative



Capital Resources (continuing business) under Depression scenario

USD, Billions



The improvement from last year's predictions is driven by

- The 2010 scenario includes a continuing decline in interest rates; the 2009 scenario did not. Lower interest rates reduce credit risk on new insurance and on the entire HECM portfolio
- Higher premium revenues starting in April 2010
- Better than expected credit scores in the 2009 and 2010 books
- Better predictions for credit scores in the future books of business



Contents



- 2010 Actuarial Review findings and additional context
- **The strength of new and recent loans**
- Responsible steps taken by FHA
- Moving forward
- Appendix



Single Family loans are the bulk of the MMI Fund portfolio, and perform better than the blended economic value and capital ratio would imply



In FY 2009, Single Family (SF) loans were **96% of the MMI portfolio**. HECM reverse loans featured a high implied capital ratio

The implied HECM capital ratio has declined significantly this year, and has caused the net decrease in the overall MMI Fund capital ratio

The FY 2009 re-estimate includes a transfer of \$1.7 billion in Capital Resources from SF to HECM accounts to bolster HECM reserves, which artificially suppresses the implied SF capital ratio

	SF loans	HECM	Total
2009 Capital Ratio (%)	0.42%	3.17%	0.53%
2010 Capital Ratio (%)	0.59%	-0.98%	0.50%
Capital ratio without transfer to HECM (%)	0.79%	-4.38%	0.50%

Note: FHA has increased HECM premiums and introduced the HECM Saver option in FY 2011. The independent actuaries estimate these changes will build capital moving forward

On a standalone basis, SF loans have a 2010 capital ratio of 0.79%



FY 2009 and 2010 loans have better risk profiles than projected, improving the Economic Value for SF loans by \$8.1 billion from last year's predictions



Percent of 2010 loan volume, by credit score and LTV¹

Percent

High Volume
 Low Volume
 Sum

2009 Review projection of the 2010 book

FICO score	680-850	5.5%	7.6%	32.0%	45.1%
	640-679	4.6%	4.1%	16.4%	25.1%
	600-639	4.2%	3.0%	14.0%	21.3%
	560-599	1.9%	0.8%	4.4%	7.1%
	500-559	0.6%	0.2%	0.6%	1.3%
	300-499	0.0%	0.0%	0.0%	0.0%
	Unknown	0.1%	0.0%	0.1%	0.2%
	Sum	16.9%	15.7%	67.4%	100.0%

	<90	90-95	>95	Sum
LTV range				

In 2009, the FHA **expected only 45.1%** of borrowers in 2010 to have FICO scores above 680

Actual composition of the 2010 book

FICO score	680-850	10.8%	6.4%	40.0%	57.2%
	640-679	5.8%	2.3%	18.7%	26.7%
	600-639	2.9%	1.1%	10.5%	14.4%
	560-599	0.4%	0.1%	0.6%	1.1%
	500-559	0.1%	0.0%	0.1%	0.2%
	300-499	0.0%	0.0%	0.0%	0.0%
	Unknown	0.0%	0.0%	0.0%	0.0%
	Sum	20%	10%	70%	100.00%

	<90	90-95	>95	Sum
LTV range				

However, actual activity in shows that **over 57.2%** of borrowers in 2010 have FICO scores above 680

¹ The decomposition does not include streamline refinance or HECM loans



Expected losses are mostly from legacy loans while loans made since last year are contributing to rebuilding the capital reserve



Expected losses

- Loans insured before 2009 are responsible for **70% of expected Single Family loan losses**
- Loans insured in FY 2007 and FY 2008 have the worst performance and are expected to experience combined losses of **\$9.7 billion**
- Seller-financed down payment assistance loans continue to tax the fund
 - To-date, losses on SFDPA loans and refinances are **\$6.6 billion**
 - Total losses due to SFDPA are estimated to cost **\$13.6 billion**
 - Without SFDPA, the capital ratio would be **above 2%**

Current and new business earn revenue

- Loans insured in FY 2010 and FY 2011 are expected to contribute a sum of **\$10.6 billion** in economic value, offsetting the losses of the worst performing years
- Future loans are expected to add **\$28.3 billion** in economic value to the MMI Fund by 2016

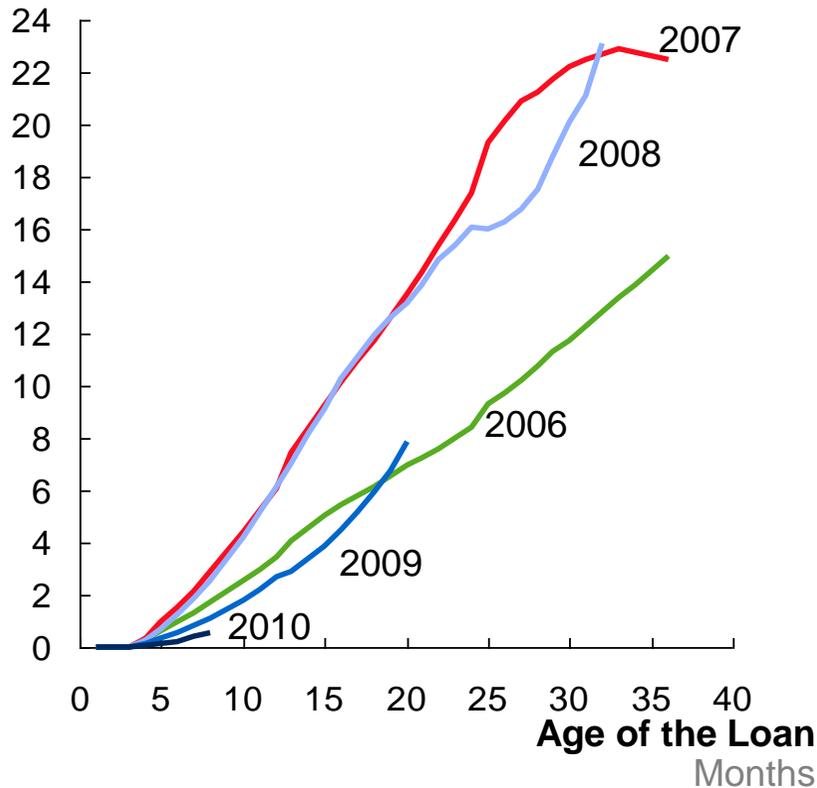


The improved risk profiles of newer FHA loans are reflected in their lower serious delinquency rates



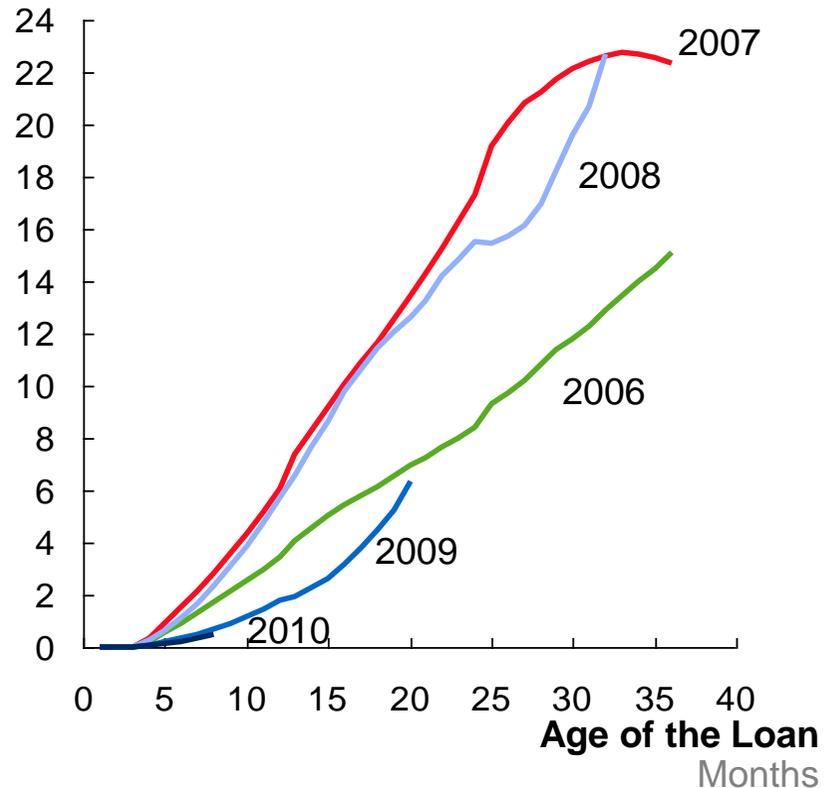
Serious Delinquency Rate (All Loans)

Percent



Serious Delinquency Rate (Excluding Streamlined Refinances)

Percent



Through the FHA streamline refinance option, the 2009 vintage is absorbing credit risk from earlier vintages, and especially from the 2005-2008 books. These loans do not represent new borrowers but are rather rate-and-term refinancings done to lower monthly payment burdens. However, the large number of loans that refinanced in 2009 have higher risk because they were affected by large house price declines and by growing unemployment. The ends of the 2008 and 2009 curves swing upward but should come down over time. This is because credit quality of new loans improved throughout each year while the ends of the curves currently only reflect originations early in each year.



Contents



- 2010 Actuarial Review findings and additional context
- The strength of new and recent loans
- **Responsible steps taken by FHA**
- Moving forward
- Appendix



FHA created a permanent risk management organization and instituted the most sweeping reforms in its history to strengthen the MMI Fund



Loan Quality and Performance Reforms

- Restructured and increased mortgage insurance premiums
- Updated minimum downpayment and credit score guidelines
- Restructured HECM program
- Modified streamline refinance transaction requirements
- Improved appraisal standards
- Revamped loan quality assurance reviews
- Proposed reduction of seller concessions

Lender Quality, Oversight, and Enforcement Reforms

- Enhanced monitoring of performance and compliance with FHA underwriting and servicing guidelines
- Took action on more than 1,600 lenders
- Increased net worth requirements
- Restructured approval and oversight of loan correspondents
- Expanded submission of audited financial statements to all lenders
- Proposed enhanced indemnification authority



Contents



- 2010 Actuarial Review findings and additional context
- The strength of new and recent loans
- Responsible steps taken by FHA
- **Moving forward**
- Appendix



FHA is on a path towards restoring the capital ratio but remains cautious and vigilant



- The MMI Fund capital ratio remains positive even after adopting more stressful base case economic assumptions and model changes
- Under every near-term economic stress scenario, with continued insurance endorsements, capital resources remain positive and FHA will remain self-sufficient
- Future loans are expected to earn net revenue to continue rebuilding the capital reserves
- Uncertainty of future housing price movements remains the biggest risk to the MMI Fund
- FHA has taken several steps to improve loan quality, reduce claim expenses, and increase lender enforcement
- FHA will continue to monitor economic conditions and may make additional policy changes to protect the MMI Fund while fulfilling FHA's mission to facilitate the housing recovery



Contents



- 2010 Actuarial Review findings and additional context
- The strength of new and recent loans
- Responsible steps taken by FHA
- Moving forward
- **Appendix**



The actuaries stress tested the capital ratio under a series of economic scenarios. These assume a wind-down with no future business after FY 2010



Moody's Scenario Name	Moody's Description of Scenario	Economic Scenario Percentile ¹	Peak-to-trough house price change ²	Capital ratio ³
Strong near term recovery	Assumes a stronger economic recovery in the later part of 2010. Assumes that HPA rate reverts back to that of the base-case scenario after the first quarter of 2012	90%	-15%	0.83%
Base case	Expected economic forecast	50%	-17%	0.50%
Mild second recession	Assumes that financial policy initiatives such as foreclosure mitigation are put in place and access to credit improves moderately, but that the improvement is too gradual to allow for a substantial rebound in the housing market until 2012	25%	-25%	-1.03%
Deeper second recession	Assumes that the moderate rebound in housing construction in the first half of 2009 pauses and reverses course due to restricted access to credit and continuing high unemployment. No significant recovery begins until mid-2012	10%	-31%	-1.80%
Complete/collapse depression	Assumes that foreclosure mitigation policies are unproductive, house prices resume their decline, and the NAR median existing sale price falls cumulatively by 45 percent from its 2005 peak to the third quarter of 2012	4%	-35%	-2.29%
Volatile interest rates	Stresses the base-case scenario with volatile interest rates	Stress test	-17%	0.70%

1 The probability that the economy will perform as bad or worse than this scenario; values given by Moody's

2 Based on FHFA house price indices, which peaked in 2007, and FHA portfolio weights by MSA; as of July 2010

3 Assumes wind-down scenario in which FHA does not insure any additional loans after FY 2010 but pays future claims on current portfolio