Federal Housing Administration

ANNUAL REPORT TO CONGRESS

The Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2015

November 16, 2015

Annual Report to Congress Regarding the Financial Status of the Mutual Mortgage Insurance Fund

Fiscal Year 2015

U.S. Department of Housing and Urban Development

November 16, 2015

Secretary's Foreword

I am pleased to present the Fiscal Year 2015 Annual Report to Congress on the status of the Federal Housing Administration's Mutual Mortgage Insurance Fund. Its findings provide very good news: the Fund has reached its congressionally mandated capital ratio. This is the first time since 2008 that it has reached this threshold. And, in addition to demonstrating tremendous growth in value, FHA has made a considerable impact in helping first-time homebuyers, low- and moderate-income families, communities of color, and the housing market as a whole.

This improvement has been several years in the making. While in the last year alone the Fund grew $19 billion in value, the past three years have shown steady gains of $40 billion. This growth is the result of FHA's prudent policy changes and program improvements, which are outlined in this report.

FHA's portfolio performance has been strong and continued to improve. Early payment delinquencies remain low and the serious delinquency rate has fallen by 35 percent over the last four years, representing an improvement of almost $35 billion over that time. And for the first time since the housing crisis, there are more FHA-insured loans curing delinquencies than going into default, thanks to FHA's improved loss mitigation processes.

FHA also reduced its annual mortgage insurance premium this fiscal year. By lowering the premium 50 basis points, from 1.35 percent to 0.85 percent, FHA opened the doors for tens of thousands of Americans to become homeowners or to refinance into a more affordable loan. This was especially important since credit remains tight for too many responsible Americans.

In the eight months since the MIP reduction, FHA has helped 75,000 additional responsible, creditworthy families with credit scores of 680 or below purchase a home compared to the previous year. The report also explains that while the premium reduction was vital for improving access, it did not alter the strong, steady, predicable growth of the Forward mortgage portfolio. The Fund's improvement was the result of sound policymaking, improved risk management, and other market factors.

Over the last 80 years, FHA-insured loans have funded approximately 13 percent of all mortgage originations, and more than 50 percent of all first-time homebuyer purchase mortgages. In the past two fiscal years alone, more than one million borrowers have relied on FHA insurance to purchase their first homes. FHA's market share is a reflection of these developments and our efforts to promote safe, affordable lending to borrowers at all income levels, and to ensure the availability of mortgage credit during national and regional downturns.

FHA has played an important role in our nation's economic comeback. Now, thanks to our programmatic improvements and a renewed focus on risk management, the Fund has truly recovered from the strain of the Great Recession. While achieving the 2 percent target represents a crucial milestone for FHA, managing the Fund goes beyond achieving the minimum capital reserve ratio. Managing the Fund requires maintaining a balance that preserves a pathway to the American Dream for today's families while anticipating the needs of tomorrow. This report explains in detail exactly what FHA has done to achieve that balance and how it is positively affecting the Fund.

Our confidence in FHA was well placed, and we look forward to continuing to work with Congress to strengthen the Fund even further – ensuring that FHA will always be a source of opportunity for responsible, underserved Americans.

Julián Castro
Secretary

U.S. Department of Housing and Urban Development

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Executive Summary

The independent actuary reports that the Mutual Mortgage Insurance Fund (MMIF, MMI Fund, or Fund) capital ratio improved by 1.66 percentage points from last year's actuarial result, increasing from 0.41 percent to 2.07 percent. The MMI Fund economic net worth has improved by $40 billion since fiscal year (FY) 2012 and is now $23.8 billion. The MMI Fund capital ratio improved by 3.51 percentage points over that time, from *negative* 1.44 percent to *positive* 2.07 percent.

The annual mortgage insurance premium (MIP) was reduced by 50 basis points on forward loans (Forwards) in January 2015 to support the Federal Housing Administration's (FHA) *Blueprint for Access* initiative. When the MIP reduction was announced, FHA communicated to stakeholders that the action was expected to introduce 250,000 new borrowers into the market over a three-year period. Purchase activity following the MIP reduction suggests that FHA is delivering on this commitment.

Mission: Whom Do We Serve

In FY 2015, FHA endorsed 1,116,232 mortgages. FHA endorsed approximately $213 billion in single family loans—$140 billion (66 percent) was used for the purchase of new and existing homes, while $73 billion (34 percent) was used for refinance mortgages. In the first three quarters of FY 2015, FHA endorsements accounted for 21 percent of the total purchase mortgage market and 8 percent of the total refinance mortgage market.

The number of purchase endorsements increased by 27 percent in FY 2015, as compared to FY 2014, reaching 753,389 loans in FY 2015, and refinance activity grew by 90 percent, reaching 362,843 loans. The increase in forward endorsements over the prior fiscal year has been driven by FHA's premium reduction, which was introduced in late-January in response to a slowly recovering housing market where credit remained constrained for first-time homebuyers and low- and moderate-income households. The modest reduction has provided a path to responsible homeownership for hardworking Americans. Key characteristics of FHA borrower composition in FY 2015 are as follows:

– The average credit score for all FHA endorsements was 680, and the average loan size was $190,928 for all mortgages, and $186,176 for purchase mortgages.
– 82 percent of FHA purchase loans (614,148 loans) were for first-time homebuyers.
– In calendar year (CY) 2014, FHA provided financing for 43 percent of all African-American borrowers, and 44 percent of all Hispanic borrowers. In contrast, in CY 2014, FHA represented just 21 percent of the total purchase market.
– African-American borrowers represented 10.4 percent of total FHA endorsements in FY 2015; Hispanic borrowers represented 17.4 percent of total FHA endorsements in the same period.
– FHA assisted more than 57,990 senior households to age in place through the Home Equity Conversion Mortgage (HECM) program.
– At the state level, during CY 2014, FHA-insured loans represented at least 20 percent of all purchase activity in 32 states. In 12 states and Puerto Rico, FHA-insured lending represented a quarter of all 2014 purchase lending. Nevada, Puerto Rico, and Arizona had the highest proportion of FHA purchase activity in 2014, with FHA-insured loans

representing 34 percent, 33 percent, and 31 percent of all purchase loans in those areas, respectively. Arizona and Nevada were particularly hard hit by the housing crisis, and FHA has played an important role in the recovery in those states.

Financial Status of the MMI Fund

The MMI Fund capital ratio reached the 2 percent statutory minimum in FY 2015, one year ahead of the actuary's 2014 projection. Economic net worth (ENW) improved by $19 billion, increasing from $4.8 billion in FY 2014 to $23.8 billion in FY 2015. The MMI Fund has increased by $40 billion dollars since FY 2012.

This year's ENW exceeds what was projected in last year's study by approximately $8.7 billion. The HECM portfolio contributed most of the relative increase in performance ($7.9 billion). This raised the HECM capital ratio from *negative* 1.2 percent in FY 2014 to *positive* 6.4 percent in FY 2015.

The value of the Forward portfolio has improved by more than $30 billion since FY 2012 increasing from *negative* 1.4 percent to *positive* 1.6 over that time. The last three years show a positive and consistent trend; the result of long-term credit strategies put into action since the start of this Administration. A few of the performance metrics that suggest the actuary's findings are sustainable:

– Early Payment Delinquencies (EPD) are at historic lows.
– Serious delinquencies are at a seven-year low.
– Loss recoveries have improved by 43 percent since 2011.

In contrast, past valuations of the HECM portfolio appear less predictable, as valuations have gained or lost more than 5 percentage points in value in each of the last four years. Thus, in recent years, much of the difference between the actual and projected value of the Fund has hinged on the difficulty of anticipating the fluctuating value of the HECM portfolio.

As FHA emerged from the economic crisis, discussions of the health of the MMI Fund focused on the prospects of the Forward portfolio. In recent years, it has become clear that the future health of the Fund also depends on the progress of the HECM portfolio.

Impact of the MIP Reduction

FHA's pricing strategy for forward loans supports FHA's housing mission and ensures long-term solvency of the MMI Fund. The annual MIP was reduced by 50 basis points on forward loans in January 2015 to support FHA's *Blueprint for Access* initiative. The MIP reduction raised concerns about time to meet the 2 percent capital ratio, impact on purchase volumes, and impact on MMI Fund solvency. Initial results indicate that:

– The MIP reduction had little impact on the time to reach the statutory capital ratio. In fact, the actuary slightly *decreased* the projected time to reach the 2 percent capital ratio for the Forward portfolio.
– In line with FHA projections, the MIP reduction has made it possible for over 75,000 new creditworthy borrowers to purchase homes in the first eight months after the MIP reduction went into place.

– The new MIP structure appropriately compensates for the credit risk of the Forward program, thus continuing to contribute to a capital cushion.

Risk Analysis and Policy Implications

While achieving the 2 percent capital ratio target represents a crucial milestone for FHA, managing the Fund goes beyond achieving a minimum capital ratio at one point in time. Prudent risk management practice should overlay the statutory capital requirement with a risk management approach that takes into account other factors, such as the health of the broader economy. For example, the HECM portfolio lost 8 percent of its value in FY 2014 while the economy was in the midst of a recovery. This suggests that a 2 percent capital cushion for HECMs would be insufficient in a severe economic downturn.

Market observers generally look to the MMI Fund capital ratio as a proxy for the health of the Forward portfolio, primarily because the Forward sub-portfolio makes up $1.0 trillion of the $1.1 trillion MMI Fund portfolio. However, significant swings in value over the last four years reflect the HECM portfolio's outsized impact on the value of the MMI Fund.

To the extent that the MMI capital ratio serves as a proxy for the health of the Forward portfolio, including HECMs in the MMI Fund will impact the perceived performance of Forwards. Thus the volatility of the HECM portfolio may adversely affect decisions for the Forward portfolio.

I. Mission: Whom Do We Serve

During its 81-year history, the Federal Housing Administration (FHA) has helped more than 40 million Americans become homeowners and has played a critical role in building America's middle class. Established as a response to the Great Depression, FHA's mission is to make financing for homeownership broadly available to Americans of all income levels and across all geographic regions. In FY 2015, FHA endorsed 1,116,232 mortgages. These mortgages went to borrowers with an average credit score of 680 and an average loan size of $190,928 for all mortgages and $186,176 for purchase mortgages. As measured by dollar volumes, 66 percent of FHA mortgages were for purchase and 34 percent were for refinances.

This chapter first summarizes FY 2015 endorsement activity for the Forward portfolio and then provides details about the diversity of borrowers served by FHA. Details about loan characteristics for the FY 2015 Forward portfolio, such as loan-to-value ratios, credit scores, and loan sizes, are presented in the Appendix.

A. NEW ENDORSEMENTS AND PORTFOLIO CHARACTERISTICS OF THE FORWARD PORTFOLIO

FHA provides mortgage insurance so that private lenders will originate mortgages for creditworthy moderate- and low-income borrowers. In FY 2015, FHA endorsed approximately $213 billion in single family loans (Exhibit I-1). Of the total FHA endorsements in FY 2015, 66 percent by dollar amount ($140 billion) were for purchase mortgages for new and existing homes, and 34 percent ($73 billion) were for refinance mortgages. To put this in context, FHA endorsements accounted for 21 percent of the total purchase mortgage market and 8 percent of the total refinance mortgage market through the first three quarters of FY 2015.

Exhibit I-1
FHA Single Family Mortgage Insurance Endorsements

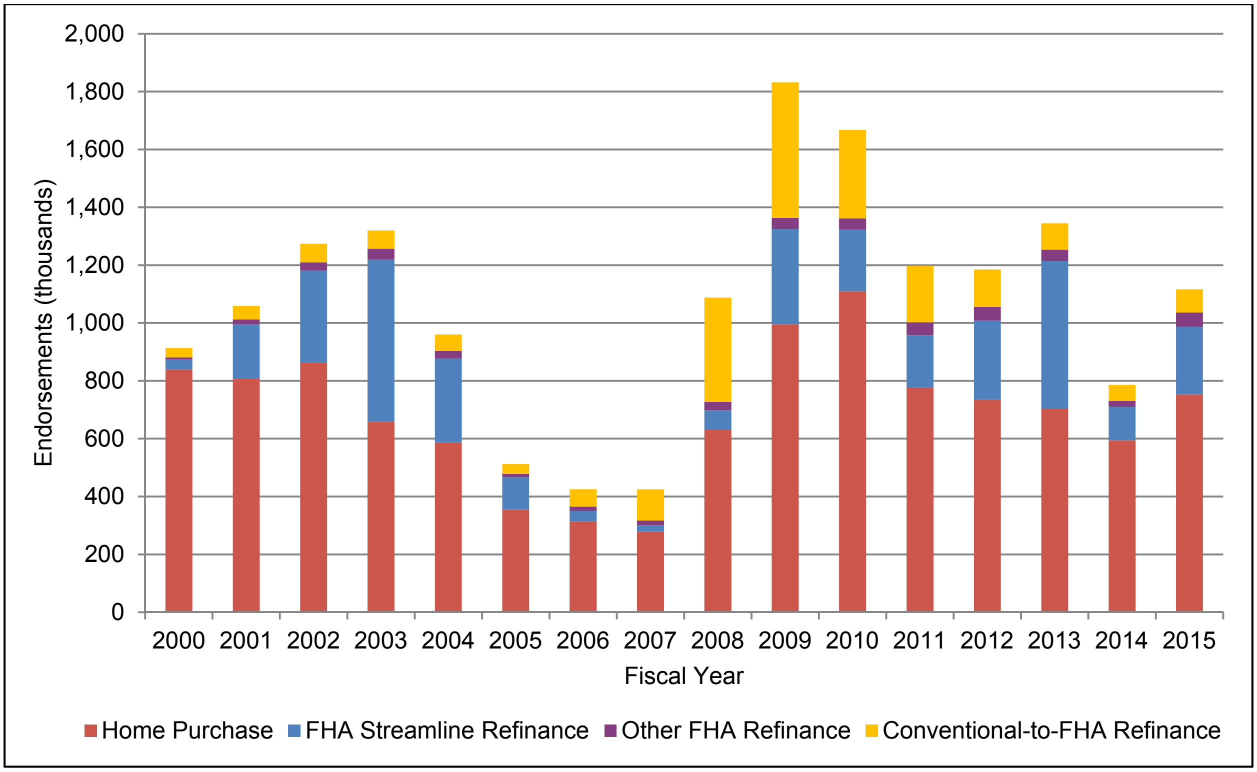
Fiscal Year	Counts by Loan Purpose					Volume ($ billions)
	Home Purchase	FHA Streamline Refinance	Other FHA Refinance	Conventional-to-FHA Refinance	All Forward Loans	
2000	839,870	34,443	6,780	32,007	913,100	94.2
2001	806,818	188,422	17,230	46,207	1,058,677	117.7
2002	862,898	318,245	28,525	64,475	1,274,143	148.1
2003	658,640	560,891	37,504	62,694	1,319,729	159.2
2004	586,110	291,483	26,147	56,695	960,435	116.0
2005	353,844	113,062	11,840	33,581	512,327	62.4
2006	313,998	36,374	14,722	60,397	425,491	55.3
2007	278,395	22,087	16,504	107,739	424,725	59.8
2008	631,655	66,772	28,510	360,456	1,087,393	181.2
2009	995,550	329,437	38,071	468,941	1,831,999	330.5
2010	1,109,580	212,896	39,598	305,534	1,667,608	297.6
2011	777,428	180,265	44,559	195,559	1,197,811	217.8
2012	733,863	274,061	47,595	129,221	1,184,740	213.3
2013	702,415	511,843	39,084	91,505	1,344,847	240.1
2014	594,999	115,040	20,963	55,353	786,355	135.2
2015	753,389	232,813	50,002	80,028	1,116,232	213.1

NOTES: This table includes all single family endorsements. Prior to FY 2009, the 203(k) program (Mortgage Insurance for Home Rehabilitation) and 234(c) program (Mortgage Insurance for Condominium Units) were not obligations of the MMI Fund. They are included for all years in this table to provide a complete picture of FHA activity. See Appendix B for an expanded table with quarterly data.
SOURCE: U.S. Department of HUD/FHA, October 2015.

1. Change in Endorsement Activity

From FY 2014 to FY 2015, the number of purchase endorsements increased by 27 percent—growing from 594,997 purchase loans in FY 2014 to 753,389 in FY 2015 (Exhibit I-2). Refinance activity, which had declined sharply in FY 2014, rebounded by 90 percent between FY 2014 and FY 2015. Much of this growth was driven by the mortgage insurance premium (MIP) reduction of 50 basis points. The reduction became effective in the second quarter of FY 2015. FHA's decision to reduce its premiums was influenced by a housing finance market in which, for the past seven years, credit had been constrained for first-time homebuyers and low- and moderate-income households. The reduction was and is intended to ease the path to responsible homeownership for hardworking Americans.

Exhibit I-2
Distribution of FHA Single Family Forward Endorsements by Loan Type



SOURCE: U.S. Department of HUD/FHA, October 2015.

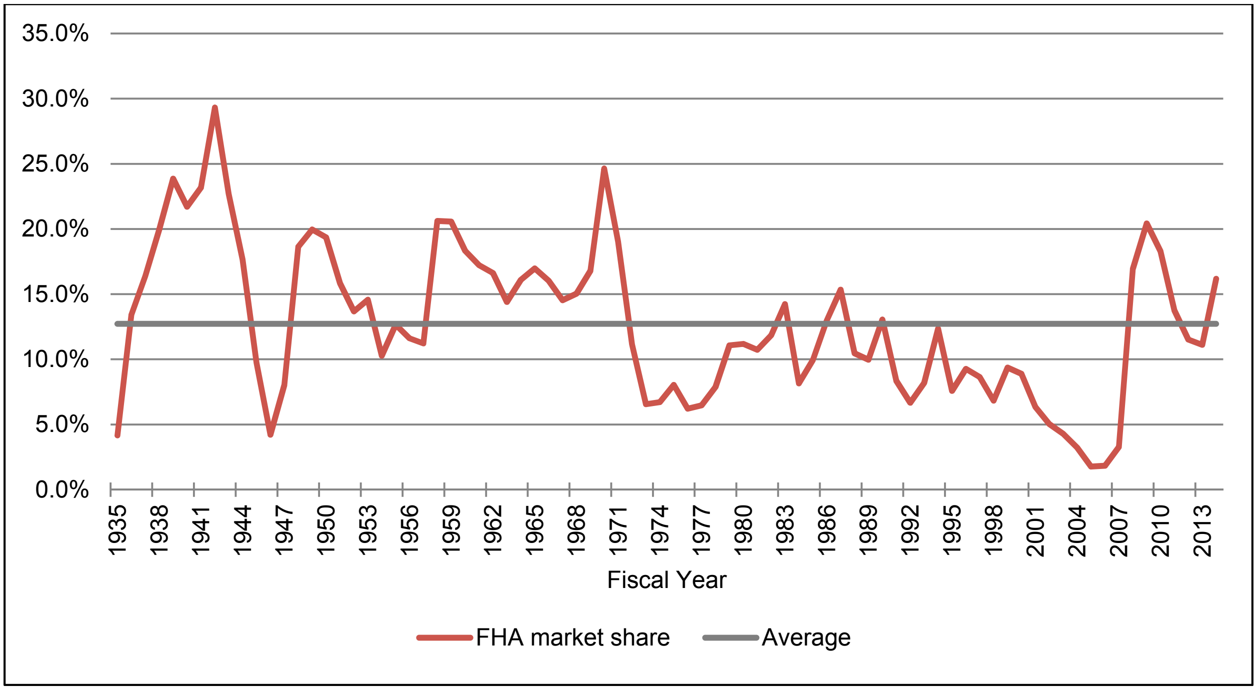
2. Market Trends and FHA's Market Presence

FHA does not target a market share. Instead, FHA's market share is a reflection of efforts to serve the agency's mission of promoting safe, affordable lending to borrowers at all income levels and to ensure the availability of mortgage credit during national and regional downturns. For example, immediately after the onset of the housing crisis, FHA played an important countercyclical role in the mortgage market, increasing mortgage activity to stabilize house prices and ensure continued credit access as private actors retreated from mortgage lending.

For historical context, during the past 81 years, the share of total mortgages originated by FHA has averaged about 13 percent of total mortgage originations, but market share has fluctuated with economic disruptions (Exhibit I-3). Since World War II, there were four instances in which FHA's market share ballooned by more than 5 percent in a year: 1948, 1958, 1970, and 2008—years that coincided with periods of economic recession, according to the National Bureau of Economic Research.[1]

[1] http://www.huduser.org/portal/Publications/pdf/HUD-FHAAT80.pdf

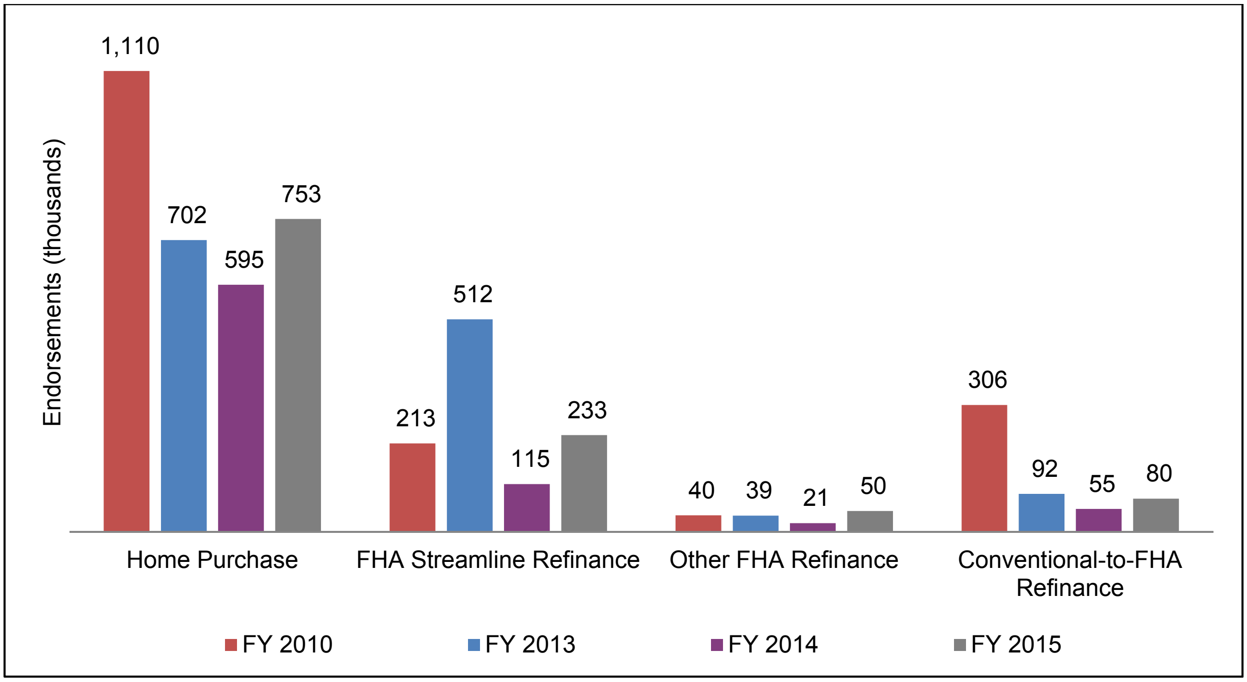
Exhibit I-3
FHA Share of Mortgage Originations



SOURCE: U.S. Department of HUD/FHA, Freddie Mac, Inside Mortgage Finance, HMDA.

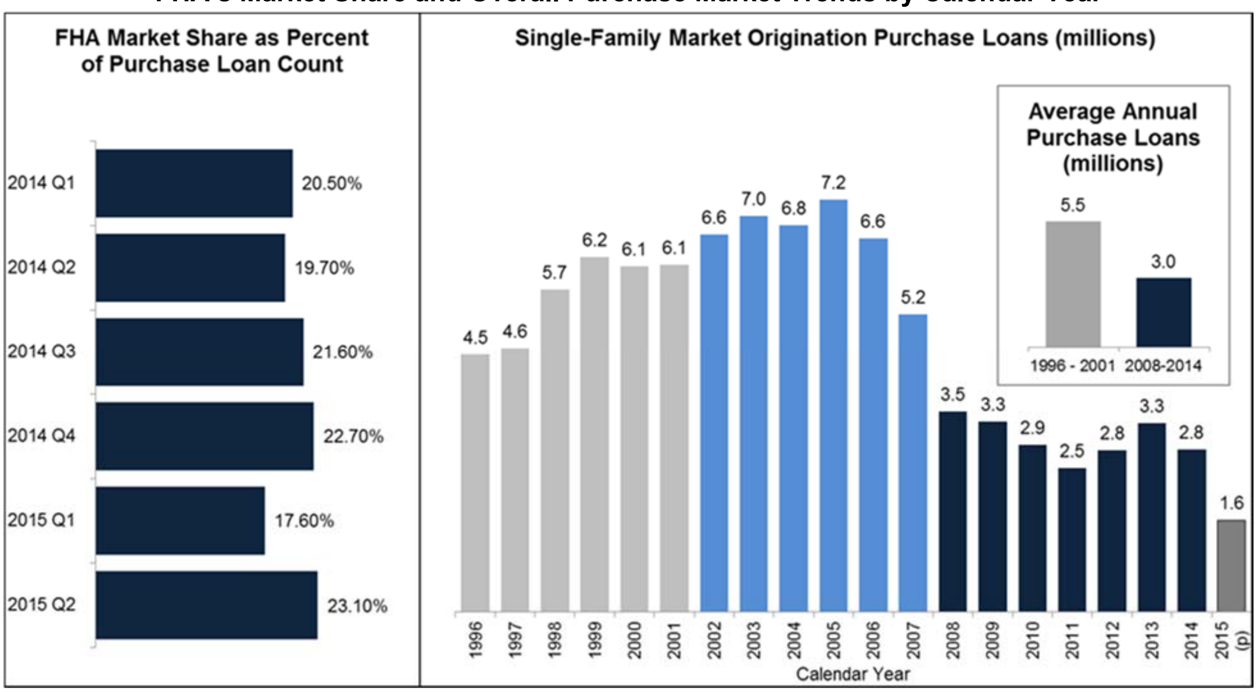
The overall economy has begun to show signs of positive momentum. Consequently, total FHA endorsement volumes declined over the previous two years as private lenders resumed mortgage lending (Exhibit I-4). However, since FHA lowered the annual MIP in January, 2015, FHA endorsement volume has rebounded.

Exhibit I-4
Change in FHA Single Family Endorsement Activity by Product



SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit I-5
FHA's Market Share and Overall Purchase Market Trends by Calendar Year



(P) = preliminary, number is subject to future revisions. Includes loan originations from October 2014–June 2015.
SOURCE: U.S. Department of HUD/FHA, October 2015; Mortgage Bankers Association of America, "MBA Mortgage Finance Forecast," September 18, 2015; CoreLogic TrueStandings ® as of October 15, 2015.

B. BORROWER CHARACTERISTICS

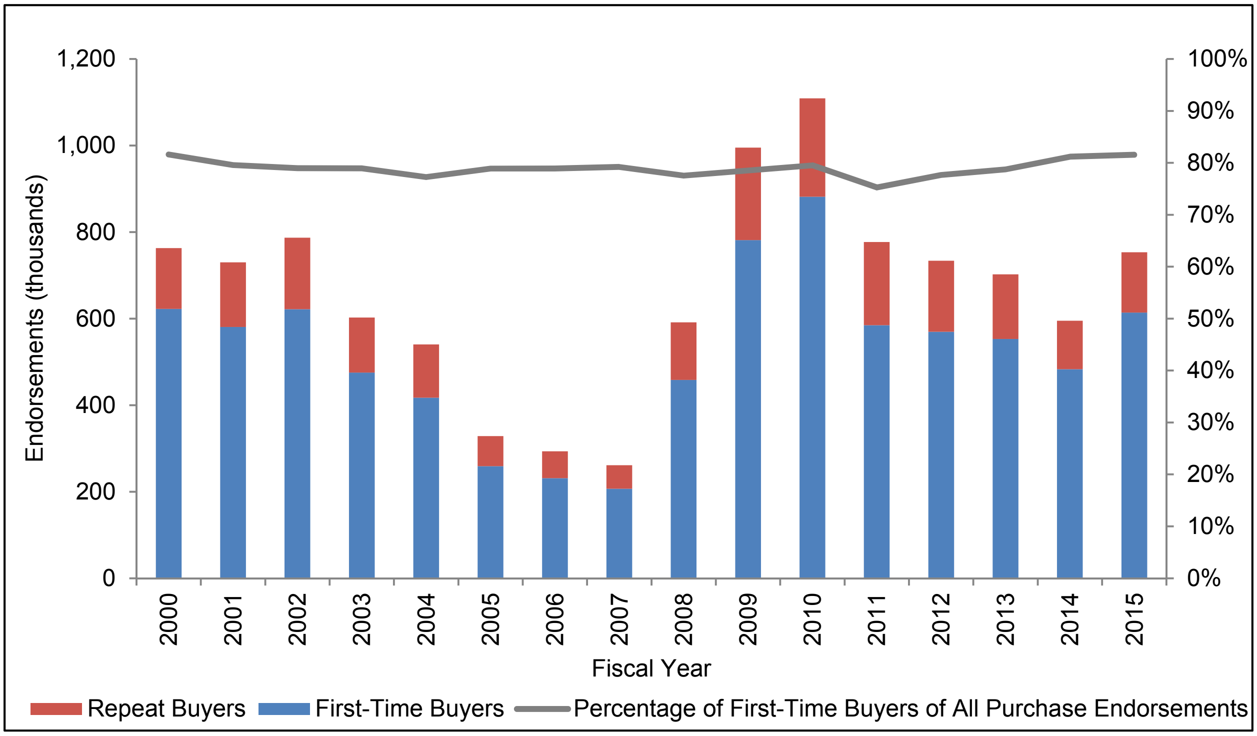
An important part of FHA's mission is to provide financing to homebuyers who, compared to those served by the conventional market, have lower wealth and pose moderately higher risks but are still creditworthy. For this reason, FHA-insured mortgages have been the product of choice, and sometimes necessity, for low-income Americans, offering a pathway to the middle class and a chance to build wealth that can be passed down through generations. In FY 2015:

- 82 percent of FHA purchase loans were for first-time homebuyers.
- 10.4 percent of FHA borrowers were African-American, and 17.4 percent were Hispanic. In calendar year (CY) 2014, FHA provided financing for 43 percent of all African-American borrowers, and 44 percent of all Hispanic borrowers. In contrast, in CY 2014, FHA represented just 22 percent of the total purchase market.
- FHA helped more than 57,990 senior homeowners age in place through the Home Equity Conversion Mortgage (HECM) program.

1. First-time Homebuyers

With its low down-payment requirement, FHA has served as a pathway to homeownership for first-time homebuyers. This has been especially true in recent years, as credit rationing and higher financing costs have impeded many potential borrowers from becoming first-time homebuyers. In FY 2015, first-time homebuyers represented 614,148 borrowers, or 82 percent of all FHA purchase originations. This is consistent with FHA's endorsement trends over the past 15 fiscal years, during which approximately 80 percent of annual purchase endorsements were for first-time homebuyers (Exhibit I-6).

Exhibit I-6
FHA Purchase Endorsements by Borrower Type



SOURCE: U.S. Department of HUD/FHA, October 2015.

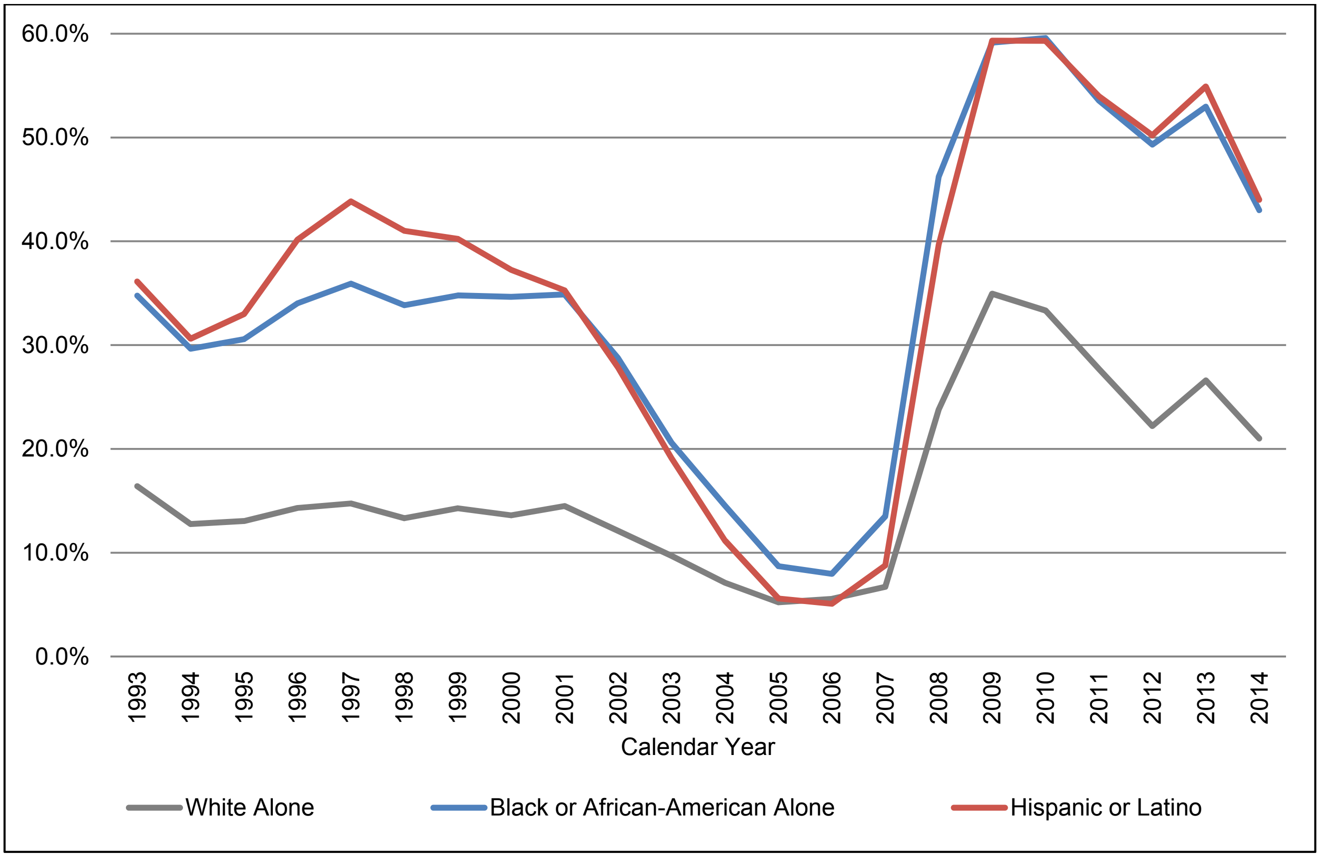
In the past two fiscal years, more than one million borrowers have relied on FHA insurance to purchase their first homes. Taking a longer view, during the past 81 years, FHA has funded approximately 13 percent of all mortgage originations *but more than 50 percent of all first-time homebuyer purchase mortgages*.[2]

2. Minority Share

FHA-insured loans are an important option for minority homebuyers. During the past 20 years, a third of all African-American and Hispanic borrowers have used FHA-insured loans.[3] Since 2008, about half of all mortgage-seeking African-American and Hispanic households have obtained their financing through FHA (Exhibit I-7).

[2] http://www.huduser.org/portal/Publications/pdf/HUD-FHAAT80.pdf.
[3] Ibid.

Exhibit I-7
FHA Originations as Share of Home Mortgage Disclosure Act (HMDA) Reported Purchase Originations by Race/Ethnicity of Borrower

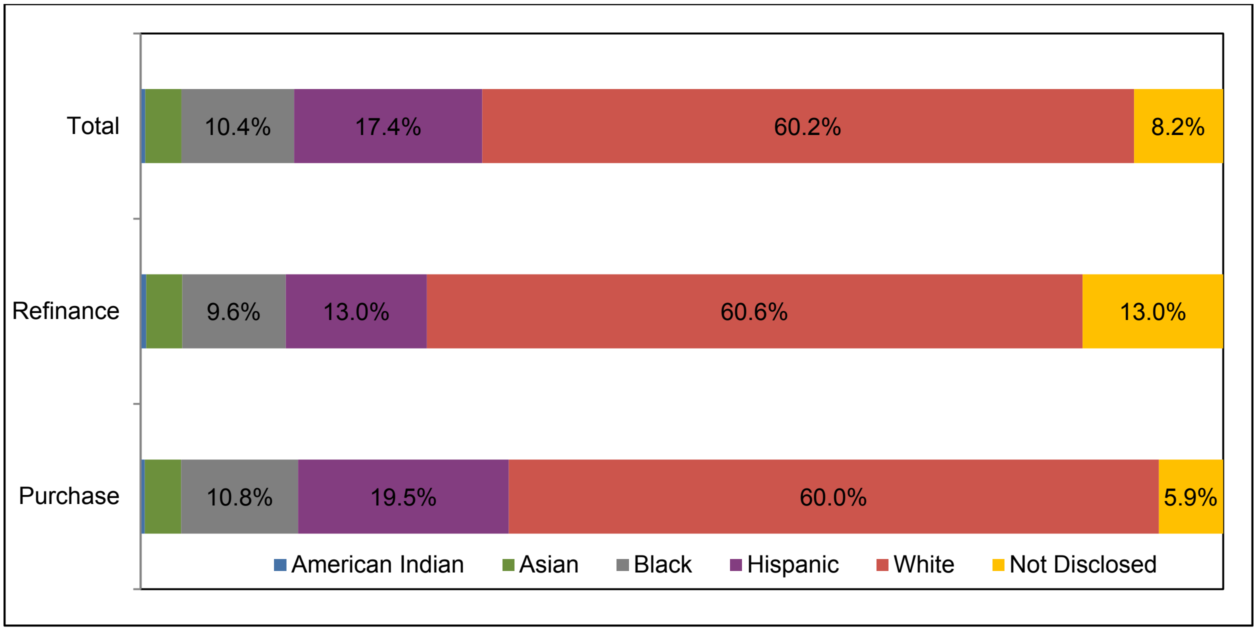


NOTE: One- to four-unit (single family) home purchase loan originations: first-lien, owner- and non-owner-occupant borrowers, including manufactured housing.
SOURCE: HMDA, 2014.

In CY 2014, according to Home Mortgage Disclosure Act (HMDA) data, FHA insurance was used for approximately 22 percent of all home purchase loans, but it was used for 43 percent of home purchases by African-American households and 44 percent of purchases by Hispanic households (Exhibit I-7).

In FY 2015, a third of FHA endorsements went to minority buyers (Exhibit I-8), consistent with long-term trends. The proportion of FHA purchase and refinance endorsements to Hispanic borrowers remained around 17 percent of all FHA endorsements in FY 2015. The proportion of FHA purchase endorsements to African-American borrowers stayed steady at 11 percent between FY 2014 and FY 2015, and the proportion of refinance endorsements that went to African-American households declined from 11 percent in FY 2014 to 10 percent in FY 2015.

Exhibit I-8
Racial Composition of FHA Single Family Endorsements, FY 2015



SOURCE: U.S. Department of HUD/FHA, October 2015.

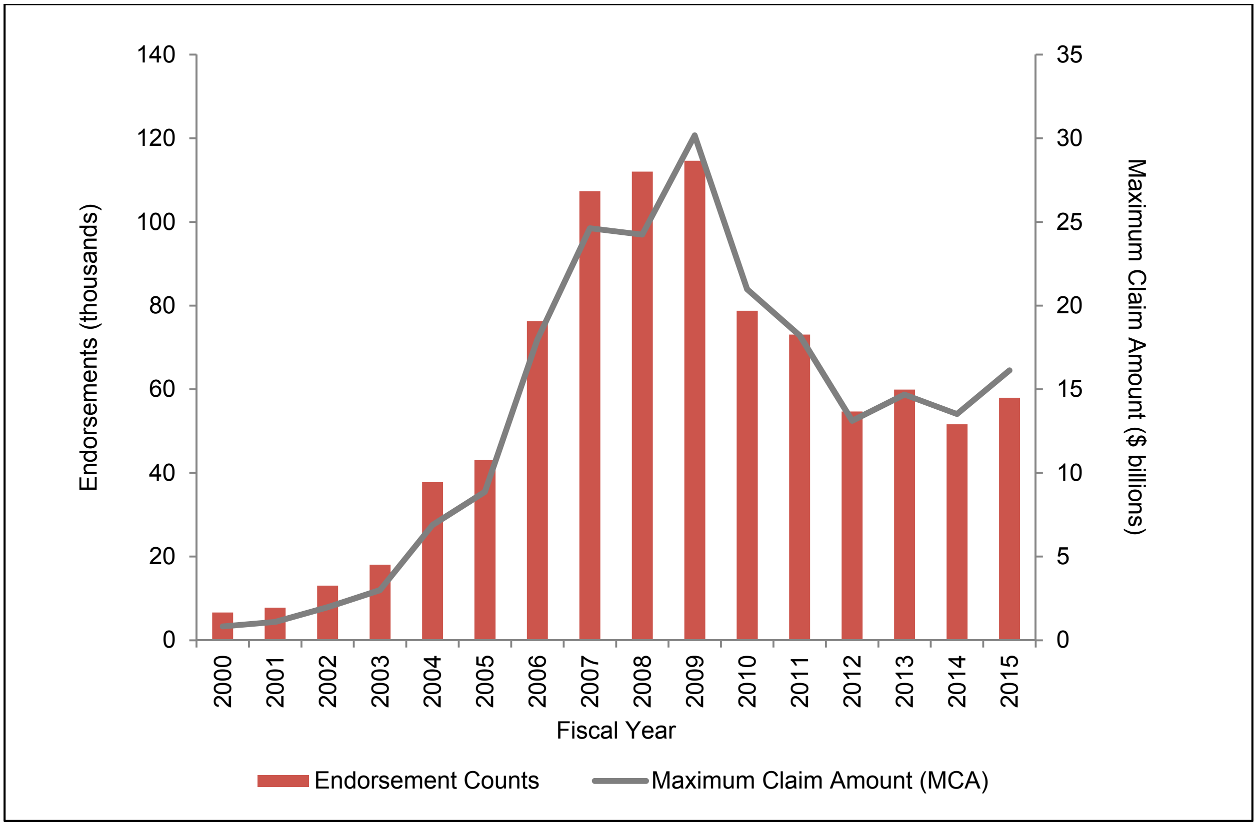
3. Seniors

FHA pioneered the development of the HECM program in 1989, and continues to facilitate the HECM product by providing insurance that protects lenders and investors from losses. The HECM program is an important option for homeowners aged 62 and older, many of whom lack a stable source of income for living expenses and other financial needs. The HECM program allows these people to convert some of the equity in their homes into cash while allowing them to age in place. However, the trade-off is that the homeowner may eventually use up all of the equity in the home. Still, the program can be attractive for senior homeowners who lack a stable source of funds. Borrowers should make the decision to participate in the program only after carefully considering the pros and cons.

In FY 2015, FHA's HECM program enabled 57,990 senior households to age in place, an increase of 6,374 borrowers from FY 2014 (Exhibit I-9). In the past two fiscal years, HECM program changes have been introduced to reduce risk to borrowers and to the MMI Fund, including lower principal limit factors,[4] changes to upfront MIP pricing, and limits on the types of fixed-interest-rate mortgages that can be insured through the HECM program.

[4] The maximum lifetime amount an elderly borrower can take out on a reverse mortgage.

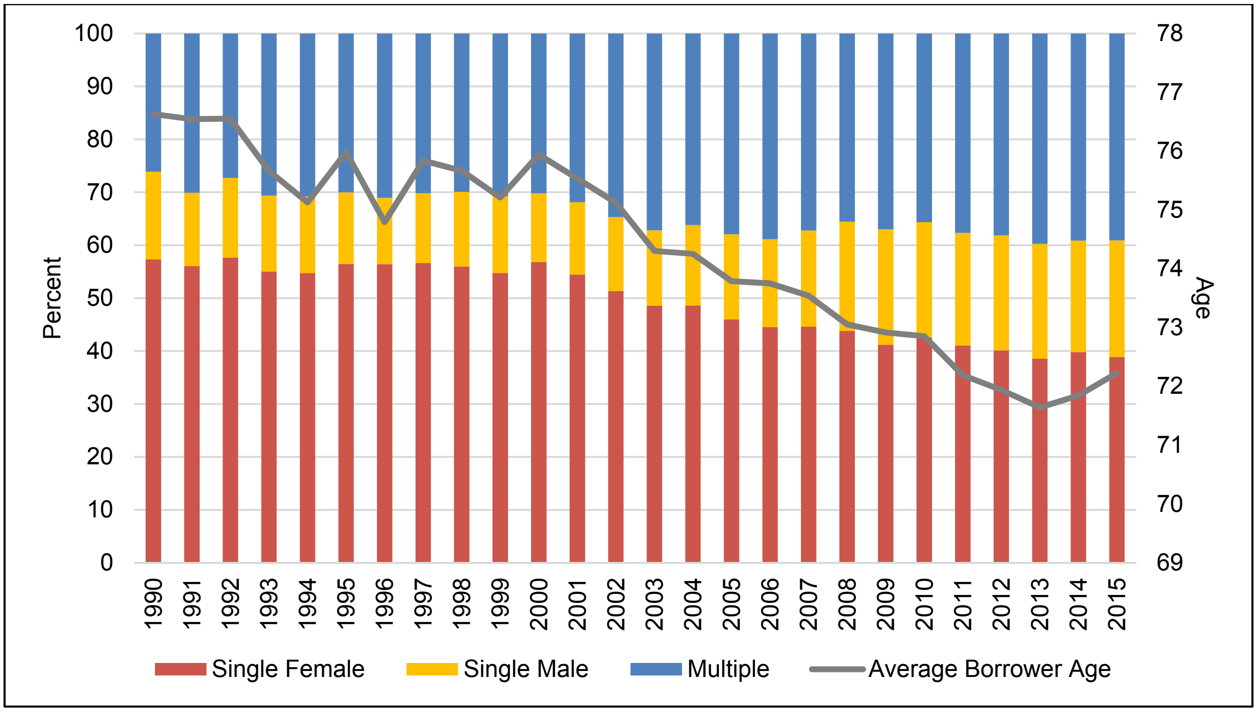
Exhibit I-9
HECM Endorsement Counts and Maximum Claim Amount



SOURCE: U.S. Department of HUD/FHA, October 2015.

In FY 2015, 39 percent of HECM borrowers were single females, representing a slight decrease from 40 percent in the prior fiscal year. Single males were 22 percent of HECM borrowers, an increase over FY 2014 (21 percent). Multiple borrowers were 39 percent of HECM borrowers, the same as FY 2014. The historical trend of borrower composition since the HECM program's inception is shown in Exhibit I-10. Overall, there has been an increase in multiple borrowers, an increase in single male borrowers, and a decrease in single female borrowers. Additionally, the borrower's average age has declined, from around 77 in FY 1990 to around 72 in FY 2015. Roughly 46 percent of HECM borrowers were between the ages of 62 and 69 in FY 2015, a decrease from 50 percent in FY 2013 and 48 percent in FY 2014.

Exhibit I-10
Composition of HECM Borrowers, FY 1990–FY 2015



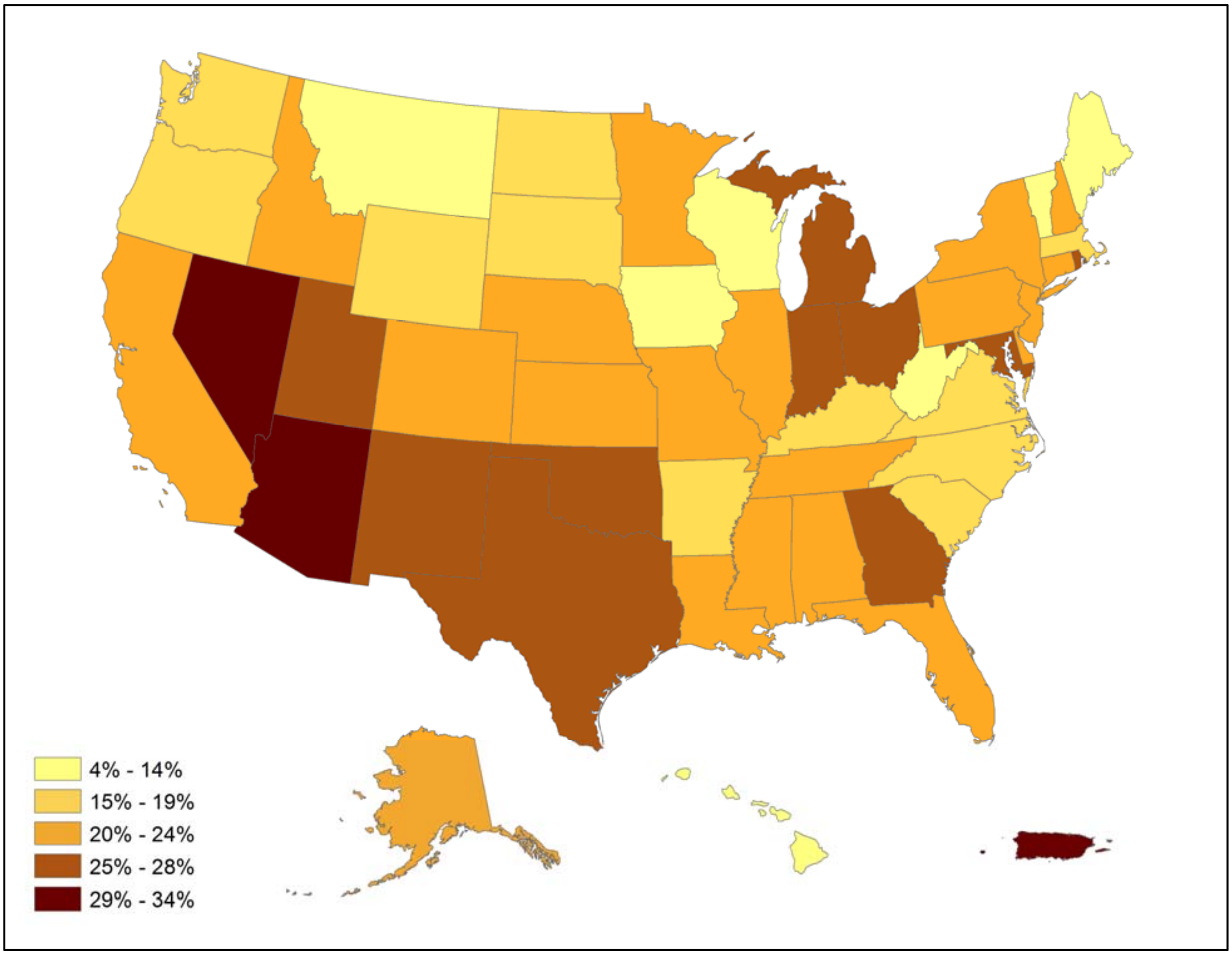
SOURCE: U.S. Department of HUD/FHA, October 2015.

4. Geographic Distribution

FHA serves borrowers in every state in the country, Puerto Rico, and the U.S. Virgin Islands. Because premiums do not vary by geography, FHA provides a stabilizing force across states, ensuring broad credit access during localized downturns. State-level data on FHA purchase endorsements, as measured by loan counts, are mapped below for CY 2014 (Exhibit I-11).

Many of the states with the highest proportion of FHA purchase activity are in the Southwest. In 32 states, FHA-insured loans represented at least 20 percent of all purchase activity. In 12 states and Puerto Rico, FHA-insured lending made up a quarter of all 2014 purchase lending. Nevada, Puerto Rico, and Arizona were the states that relied most heavily on FHA purchase activity in 2014, with FHA-insured loans endorsing 34 percent, 33 percent, and 31 percent of all purchase loans in those places, respectively. In contrast, only two states, Vermont and Hawaii, had FHA-insured lending account for less than 10 percent of annual purchase originations. In Hawaii, FHA-insured loans were just 4 percent of total purchase originations. The low proportion of FHA activity in Hawaii arises from the state's high housing costs. Overall in 2014, 21 percent of all purchase mortgage originations across the country were FHA purchase loans.

Exhibit I-11
FHA Purchase Endorsements as a Proportion of Total State Purchase Originations, CY 2014

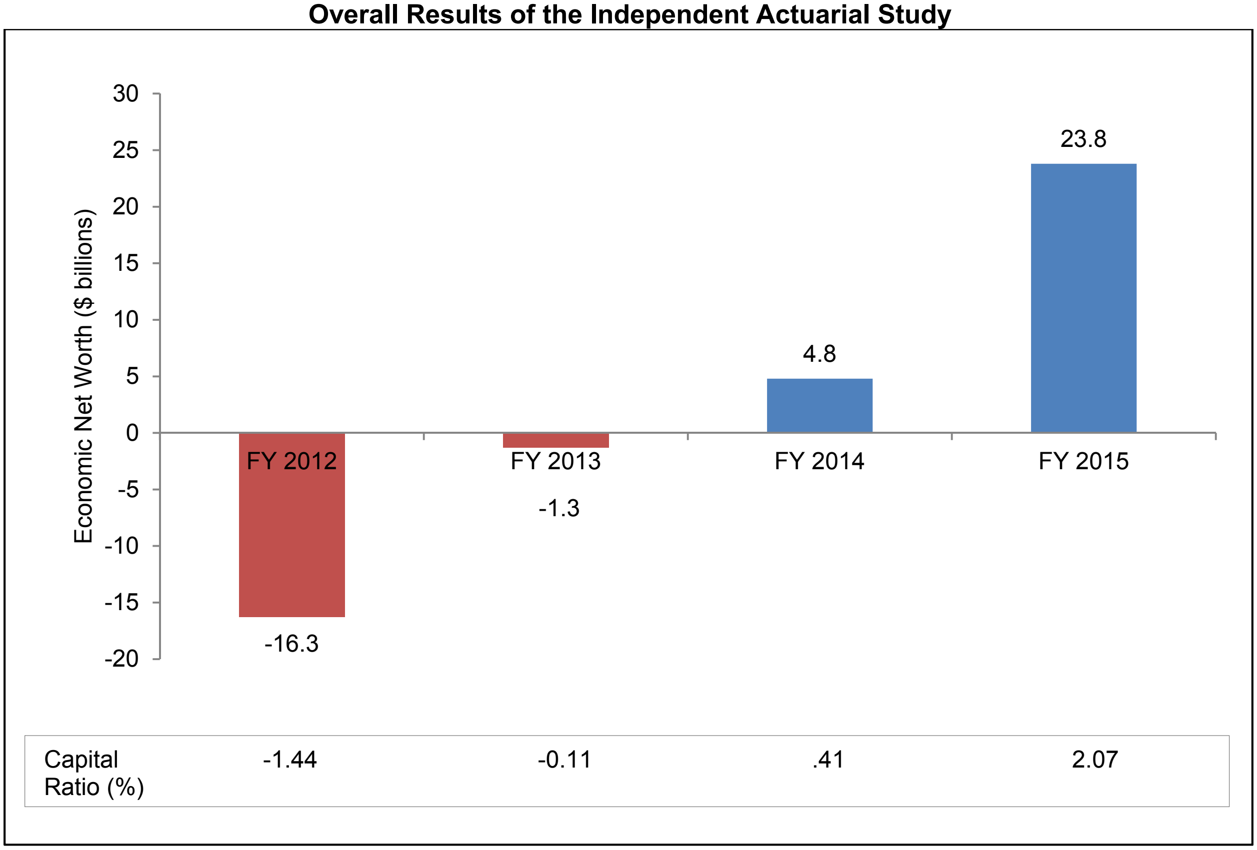


NOTE: See Exhibit B-4 for values by state.
SOURCE: HMDA, 2014.

II. Status of the Mutual Mortgage Insurance Fund

The independent actuary reports that the MMI Fund's economic net worth improved by $19 billion from last year's actuarial result, increasing from $4.8 billion in FY 2014 to $23.8 billion in FY 2015. The MMI Fund has improved by $40 billion since FY 2012, as shown in Exhibit II-1. The MMI Fund capital ratio similarly improved by 3.5 percentage points over that time, from *negative* 1.44 percent to *positive* 2.07 percent.

Exhibit II-1
Overall Results of the Independent Actuarial Study



SOURCE: FY 2012–FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

The remainder of this chapter summarizes findings of the Independent Actuarial Report and provides more details of both the Forward and HECM portfolios. The final written reports from the independent actuary are available online in the FHA/Office of Housing Reading Room.[5]

A. FINANCIAL STATUS OF THE MMI FUND

As outlined in the National Housing Act, economic net worth is defined as the sum of:

1. Net capital resources.

[5] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgrroom.

2. The actuary's result of the present value of projected mortgage insurance premiums (MIP) expected to be generated by the current portfolio less the actuarial estimate of the present value of projected credit losses for the current portfolio over the life of the loans.

The capital ratio is then calculated by dividing the economic net worth (ENW) by the value of the outstanding insured portfolio (insurance in force or IIF) at the end of the relevant fiscal year. Exhibit II-2 shows these calculations and changes from last year.

Exhibit II-2
Changes to the Capital Resources and Capital Ratio of the MMI Fund ($ millions)

	FY 2014	FY 2015	Improvement
Capital resources at end of fiscal year	28,432	30,862	2,430
Actuary's present value of future cash flows on outstanding insurance	-23,666	-7,040	16,626
Economic Net Worth (ENW) (row 1 + row 2)	**4,766**	**23,822**	**19,056**
Amortized insurance in force (IIF) at end of fiscal year	1,156,741	1,151,458	-5,283
Capital Ratio (ENW / IIF)	**0.41%**	**2.07%**	**1.66%**

SOURCE: FY 2014 and FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

The Forward portfolio by itself has not yet reached a 2 percent capital ratio. Exhibit II-3 separates the MMI Fund into its two sub-portfolios—forward loans and HECMs.

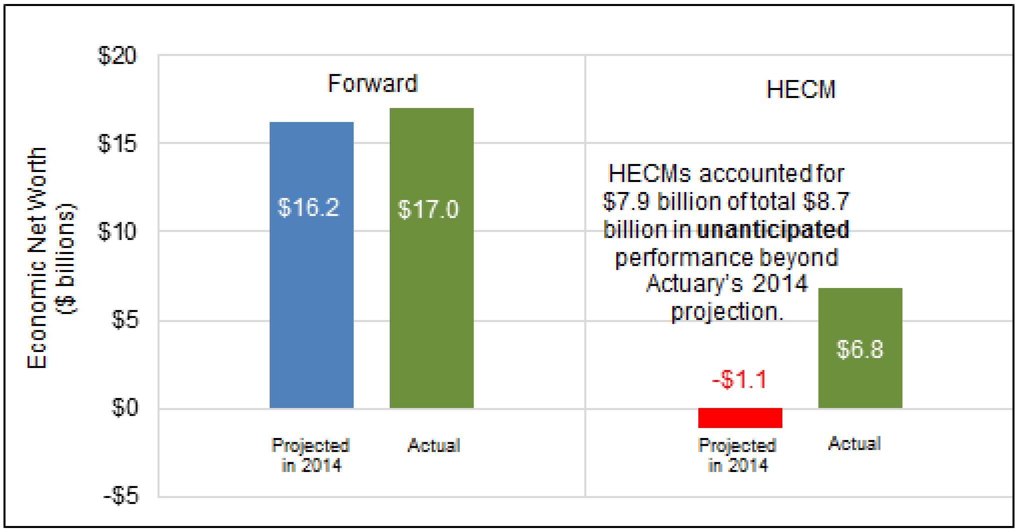
Exhibit II-3
Economic Net Worth of the MMI Fund ($ millions)

	Economic Net Worth	Insurance in Force	Capital Ratio
Forward	17,044	1,046,224	1.63%
HECM	6,778	105,234	6.44%
MMI Fund	23,822	1,151,458	2.07%

SOURCE: FY 2014 and FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

This year's ENW exceeds what was projected in last year's study by approximately $8.7 billion. The HECM portfolio contributed most of the relative increase in performance ($7.9 billion). This raised the HECM capital ratio from *negative* 1.2 percent in FY 2014 to *positive* 6.4 percent in FY 2015. The Forward portfolio added $0.8 billion, as shown in Exhibit II-4.

Exhibit II-4
Economic Net Worth of the MMI Fund, FY 2015
2014 Projection vs 2015 Actual



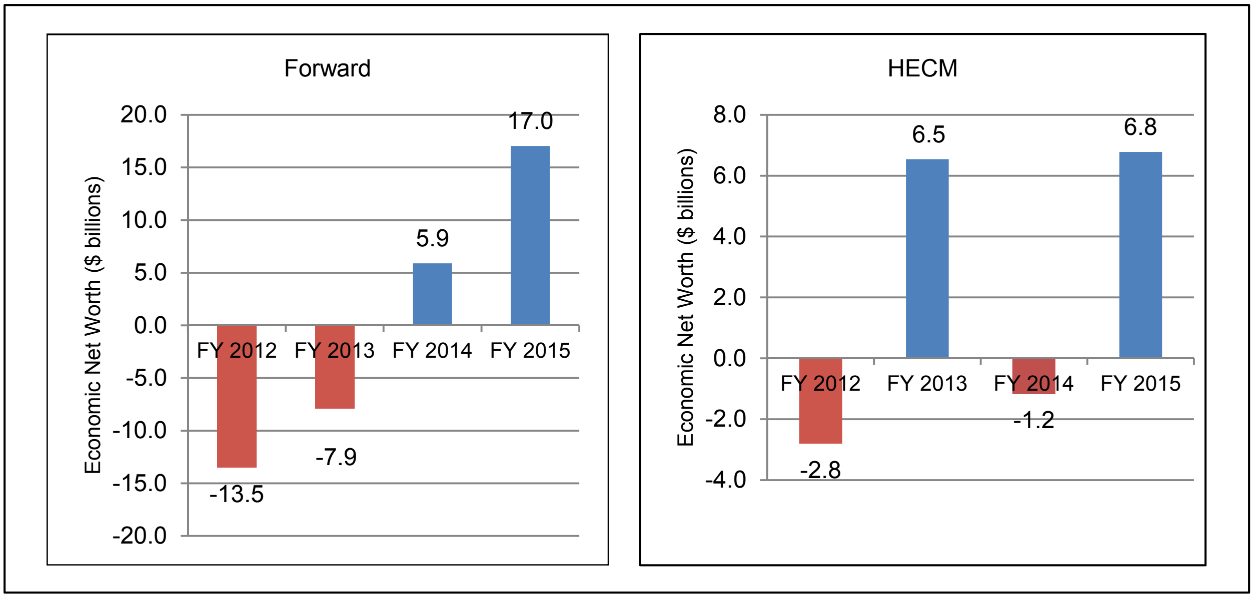
SOURCE: FY 2014 and FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

B. ACCURACY OF PROJECTED RESULTS

Projecting results is subject to forecast error. Exhibit II-5 compares the ENW of Forwards and HECMs. The value of the Forward portfolio has improved by more than $30 billion since FY 2012. The last three years show a positive and consistent trend.

In contrast, past valuations of the HECM portfolio are far more volatile. This year the actuary places the value of the HECM portfolio at $6.8 billion, after projecting in FY 2014 that the HECM portfolio would increase marginally from *negative* $1.2 billion in FY 2014 to *negative* $1.1 in FY 2015. In recent years, much of the difference between the actual and projected value of the Fund has hinged on the difficulty of anticipating fluctuations in the value of the HECM portfolio.

Exhibit II-5
Economic Net Worth under Base-Case Estimates, FY 2012–FY 2015



SOURCE: FY 2012–FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

Our assessment of the year-to-year projections for each sub-portfolio is discussed in greater detail throughout the remainder of this chapter.

1. Stable Performance Expected from the Forward Portfolio

Exhibit II-5 shows that the value of the Forward portfolio has steadily improved since FY 2012 by more than $30 billion. Other measures of the health of the Fund show similar progress—improvements in the credit quality of new production, reduced delinquencies, and higher recoveries on distressed assets.

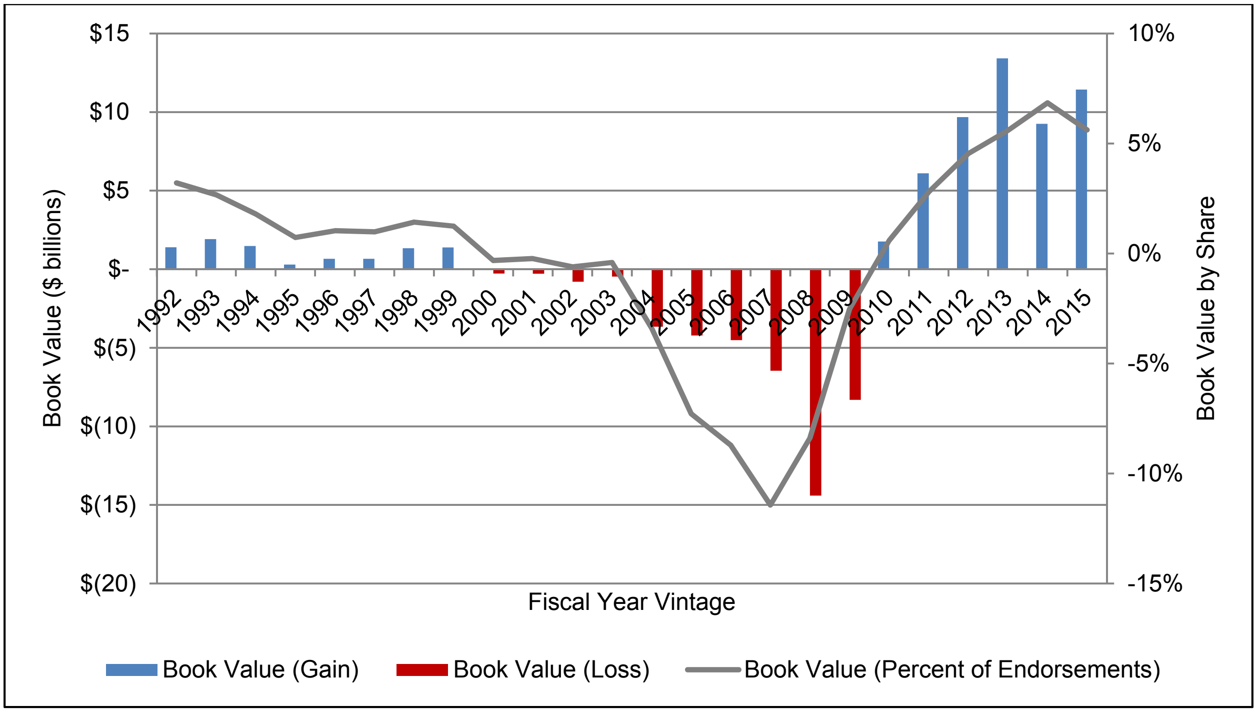
a) Improved Credit Quality of New Production

In response to the extreme risk exposure FHA experienced during the global financial crisis, FHA has made substantial changes to its credit guidelines. Hard cutoffs (e.g., minimum credit scores) are not the dominant approach used. Instead, FHA relies on risk-based underwriting to discourage extreme risk layering, but also recognizes that borrowers with a weakness in one risk area might still be good credit risks because of offsetting strengths in other areas. FHA uses its Technology Open to All Lenders (TOTAL) Scorecard to rank borrowers by credit risk, based on many indicators, including credit scores, reserves, and income ratios. FHA tightened its credit standards in FY 2013 by referring more higher-risk loans—those that did not rank well under TOTAL—to manual underwriting. Other changes that materially improved the quality of post-crisis loans:

— A 10 percent down payment is required on loans with credit scores less than 580.
— FHA's manual underwriting guidelines were strengthened to discourage extreme risk layering. For example, manual underwriting is now required for borrowers with credit scores under 620 and a high debt-to-income ratio.
— Seller-funded down-payment assistance is no longer allowed. According to the actuary, loans with these features account for almost $16 billion in losses to the Fund.

Improving the quality of incoming business increases the value of the Forward portfolio slowly but steadily. First, each individual vintage (cohort) adds relatively small but measurable incremental value to the portfolio. Second, as the relative share of successive post-2009 vintages increases, the overall impact of the detrimental older vintages (see Exhibit II-6) diminishes. For example, the 2005–2008 vintages now represent only 10 percent of the Forward portfolio.

Exhibit II-6
Book Value by Vintage, FY 1992–FY 2015



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

While the overall effect of any individual vintage year on a $1 trillion portfolio is limited, a steady accumulation of high-quality loans over many years improves the Fund. Other metrics speak to the superior quality of post-2009 production.

i. Risk Exposure Over the Last Six Vintages Is Lower Than Historic Norms

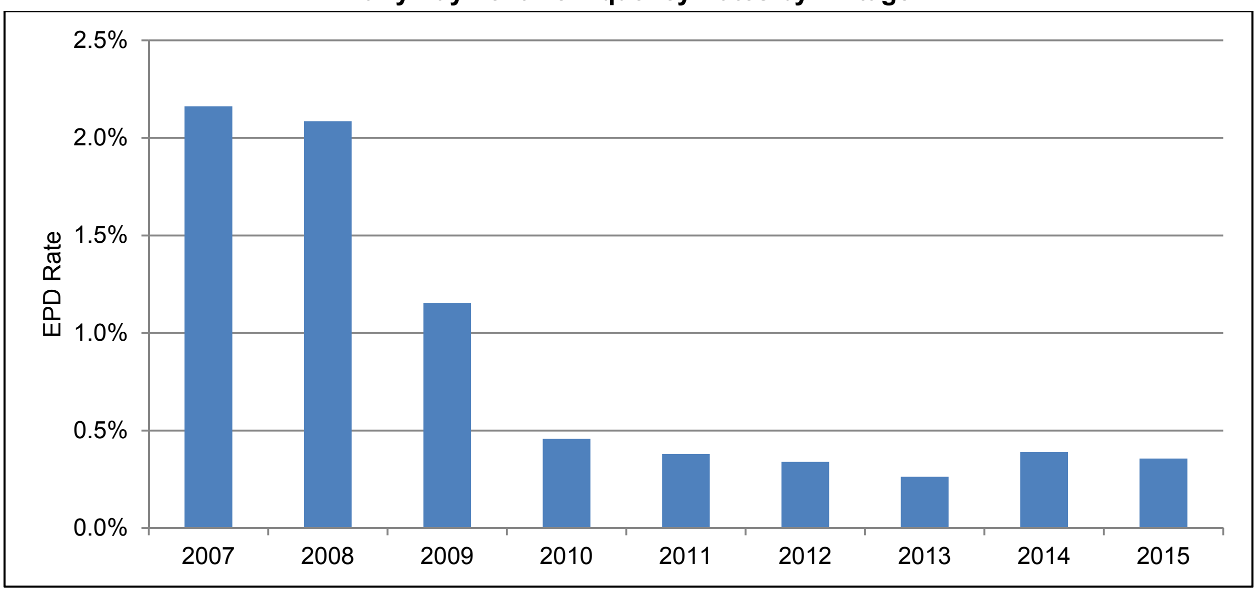
Credit scores provide one picture of the improved risk profile. For example, when FHA performed its countercyclical function in 2007 and 2008, more than 50 percent of FHA originated loans had credit scores less than 640, and 30 percent had credit scores less than 580. Both of these shares were substantially higher than historic norms. As the market recovered in 2010 and 2011, the pendulum swung back, and the share of loans with credit scores greater than 720 grew well above historic norms. In 2014, FHA introduced the *Blueprint for Access*, an initiative aimed at continuing the shift of FHA's business back toward making loans to its traditional borrower profile, somewhere between the borrower characteristics of 2007–2008 and 2010–2011. Current MIP pricing accommodates this anticipated shift.

ii. Early Payment Delinquencies (EPD) Continue at Historic Lows

The quality of new business is reflected by early payment delinquencies (EPD) rates. The EPD rate is the rate at which loans experience 90-day delinquencies within the first six months of origination, another metric that suggests the sustainability of the recovery in the Forward portfolio. EPD rates provide the first indication of potential credit performance of newly insured loans and are a leading indicator of the long-term claim risk of a particular book of business.

The EPD performance of FHA's portfolio in FY 2015 continued trends seen in recent years, as newer books of business vastly outperform those insured in prior years. EPD rates for the FY 2010 through February 2015 vintages are less than 20 percent of the EPD rates for the FY 2007 and 2008 vintages (Exhibit II-7).

Exhibit II-7
Early Payment Delinquency Rates by Vintage

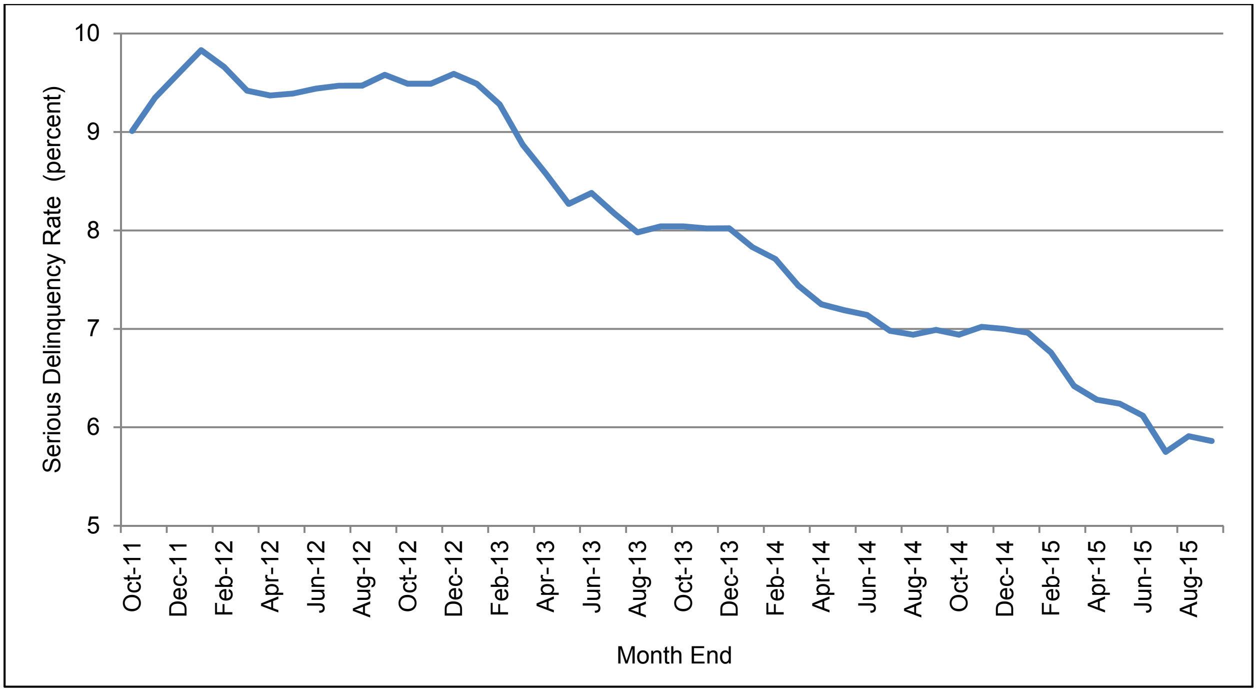


NOTE: FY 2015 includes loans with beginning amortization dates from October 2014 through February 2015.
SOURCE: U.S. Department of HUD/FHA, October 2015.

iii. Serious Delinquencies Are at a Seven-Year Low

The number of seriously delinquent FHA loans (loans that are 90 or more days past due) continued to decline in FY 2015. Exhibit II-8 shows the serious delinquency rate has fallen by 35 percent over the last four years, a nearly $35 billion improvement in the size of the seriously delinquent portfolio over that time.

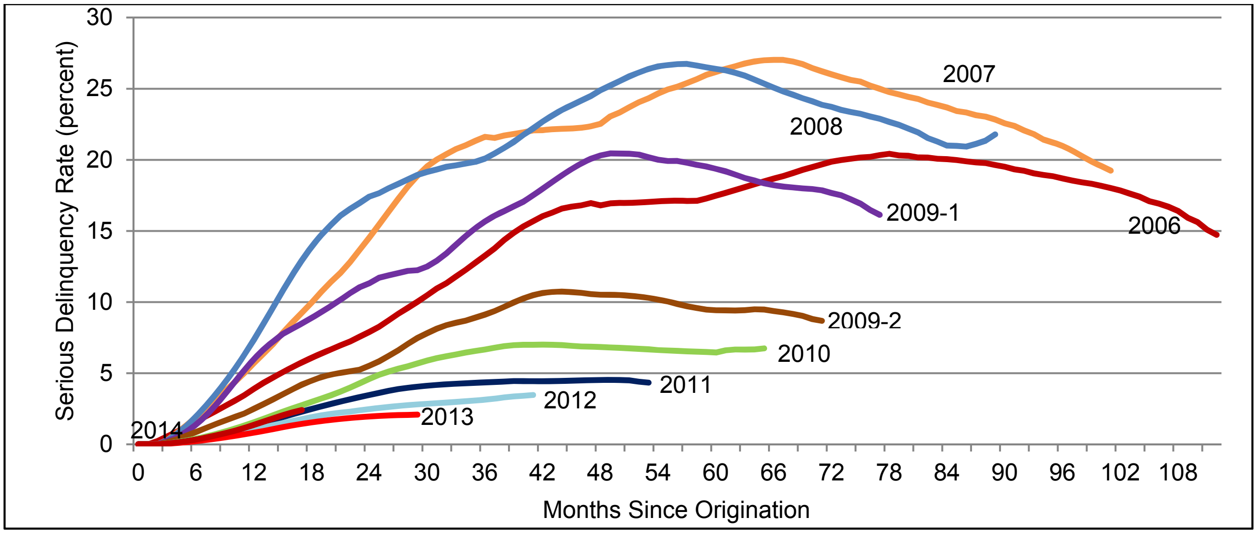
Exhibit II-8
FHA Serious Delinquency Rate



SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit II-9 shows serious delinquency rates by vintage and provides further evidence of the improving quality of more recent loan endorsements. At the end of their first year, the vintages from FY 2006–FY 2008 had serious delinquency rates more than four times higher than those of the FY 2010–FY 2014 vintages. The FY 2009 vintage was such a transitional year in terms of improving loan quality that the performance for that year is broken into two sub-vintages.

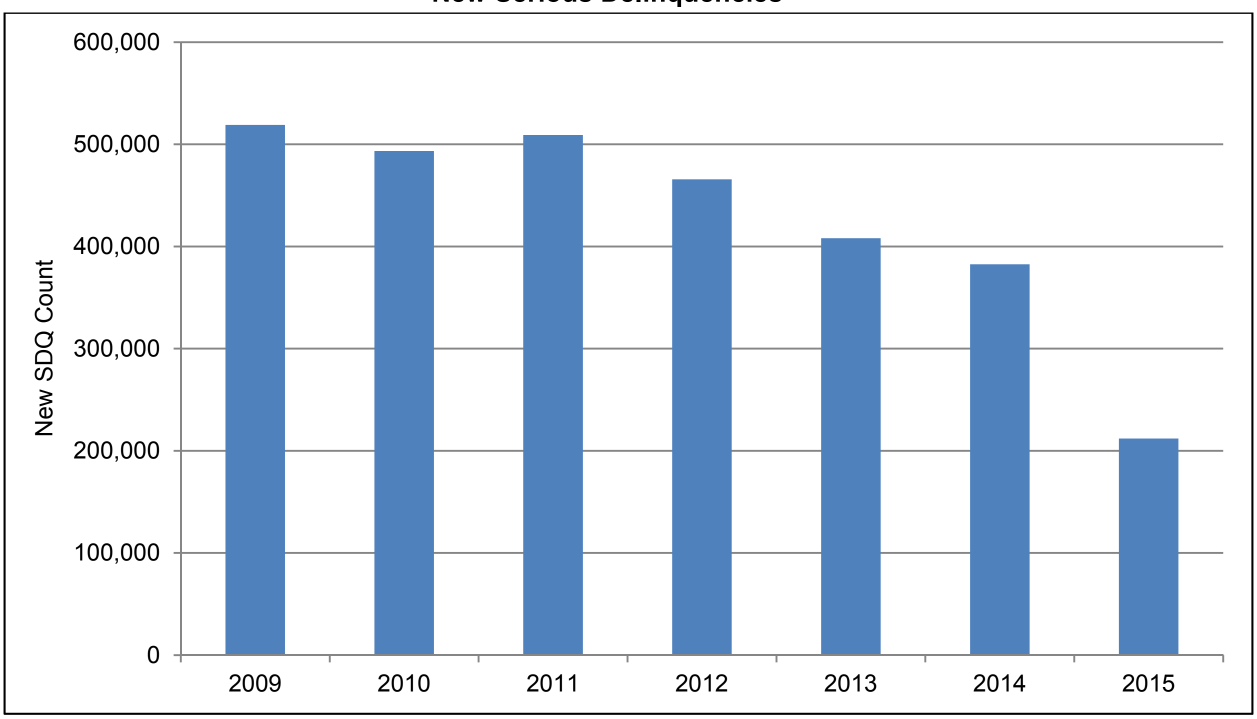
Exhibit II-9
Serious Delinquency Rates by Origination Vintage



NOTES: The 2009 vintage is separated into two parts, representing loan originations from October through March in 2009-1 and loan originations from April through September in 2009-2. Excludes streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit II-10 shows that the number of new seriously delinquent loans has decreased by about 40 percent in the last year alone.

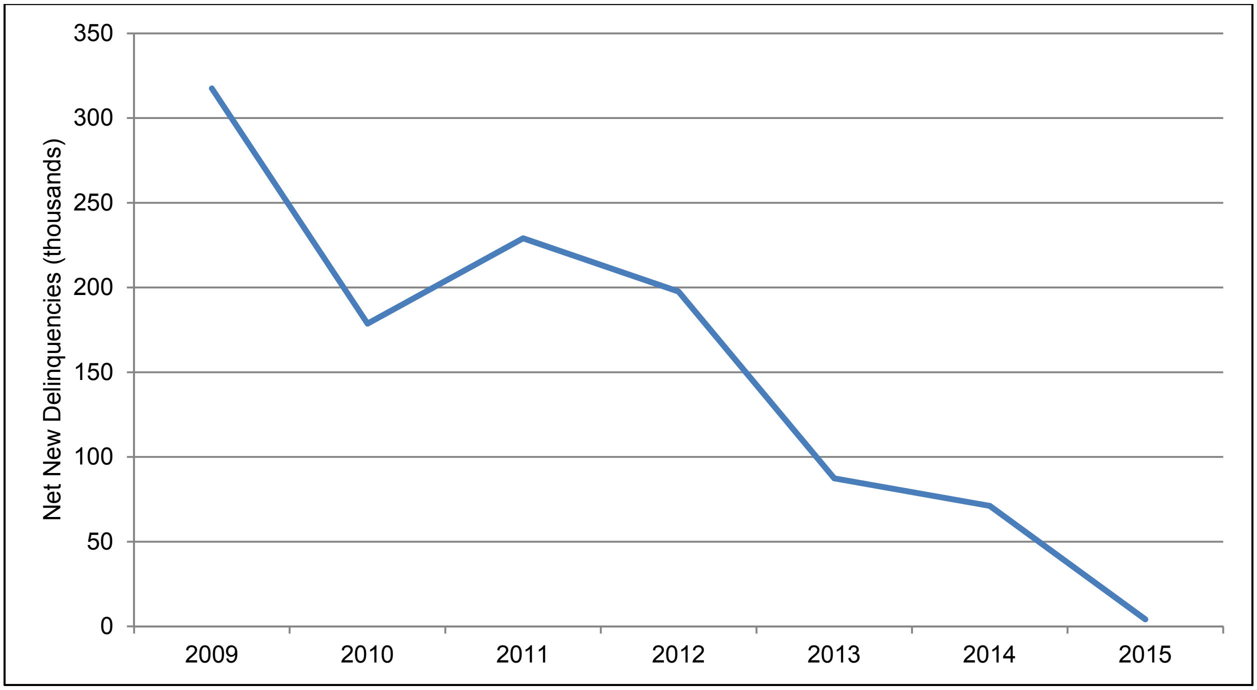
Exhibit II-10
New Serious Delinquencies



SOURCE: U.S. Department of HUD/FHA, October 2015.

As a result of the significant reduction in serious delinquencies, for the first time since the beginning of the crisis, the number of borrowers who cure their seriously delinquent loans is now equal to the number of borrowers who become seriously delinquent (Exhibit II-11).

Exhibit II-11
Net New Delinquencies



SOURCE: U.S. Department of HUD/FHA, October 2015.

b) Loss Recoveries Improved by 40 Percent Since 2011

The 2014 actuarial review projected that more than $35 billion in claims would come from loans with serious delinquencies, highlighting the importance of loss mitigation efforts. In response, in FY 2015, FHA continued its focus on further reducing loss severities associated with the legacy book—delivering on this commitment through an overall asset management strategy targeted at keeping borrowers in their homes. This was primarily accomplished through enhancement of existing loss mitigation tools such as modification programs and streamlined refinancing.

When these remedies do not achieve the desired goal to keep borrowers in their homes, FHA has pursued a more diversified approach to distressed asset disposition. FHA has done this by expanding existing, but heretofore infrequently used, initiatives that allow for better alignment of outcomes, since no single execution path consistently outperforms in all situations. Two successful expansions include the 601 Note Sales and Third Party Sales, described below.

i. Expansion of the 601 Note Sales Program into the Distressed Asset Stabilization Program (DASP)

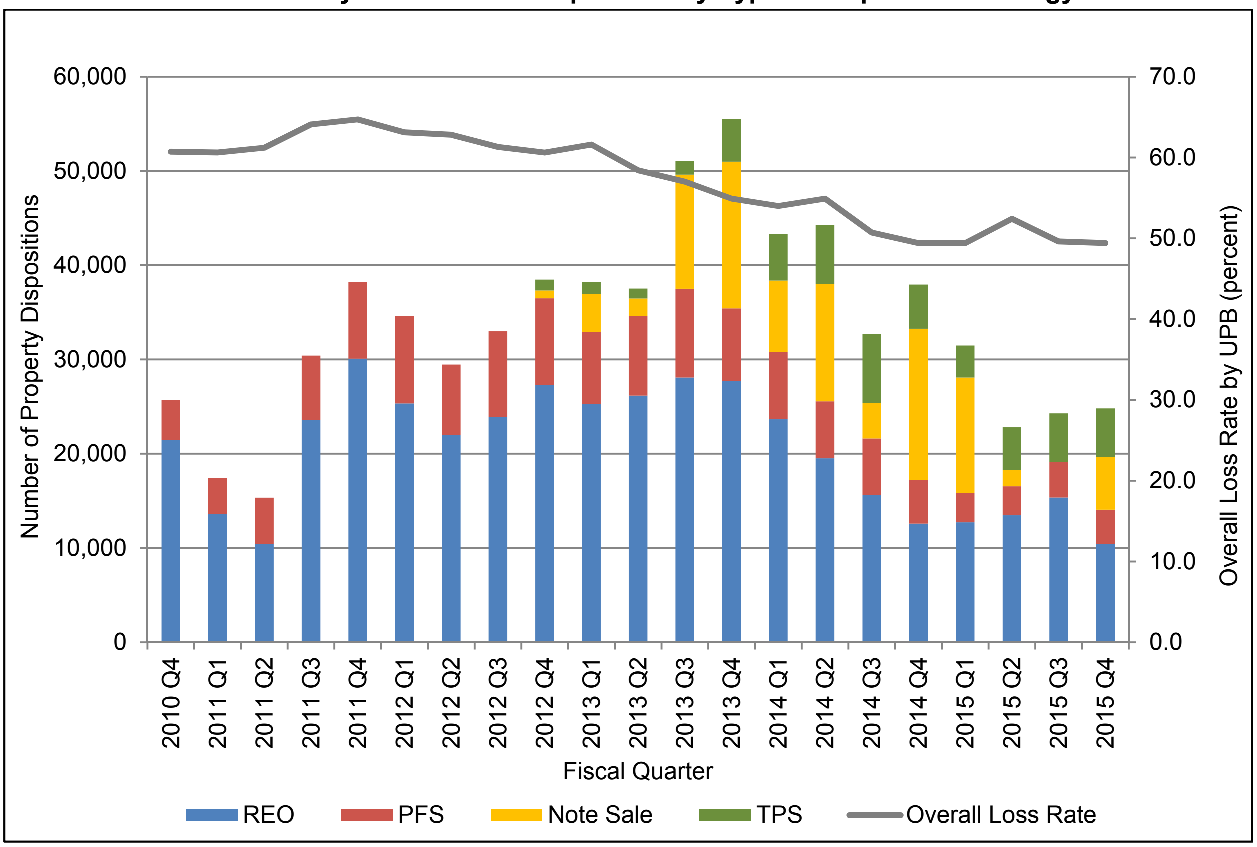
FHA began expanding the 601 program in 2012, and this evolved into the DASP. Since 2013, FHA has sold more than 92,000 nonperforming loans. FHA estimates that DASP recoveries over that period netted $2.2 billion, about $24,000 per unit, over what would have been collected through the standard real estate owned (REO) execution. Through DASP, defaulted notes are sold in bulk to third-party purchasers without ever being conveyed to FHA. DASP has been especially useful in clearing up the backlog of seriously delinquent loans that have been in the foreclosure pipeline. DASP has the added component of a post-sale requirement that purchasers document efforts to contact borrowers and apply tools to avoid foreclosure.

ii. Third Party Sale (TPS) Program

Through the TPS program, individual foreclosed properties secured by non-performing, FHA-insured loans are offered for sale to third-party purchasers before conveyance. TPS auctions are of individual properties, unlike DASP, which is used to sell pools of loans in a bulk sale. Participation in TPS has expanded from 5 percent of dispositions in FY 2013 to 15 percent in FY 2015.

Prior to 2010, the REO alternatives—short sales, note sales, and third party sales–were about 10 percent of the total dispositions per year. The share of REO alternatives increased to about 25 percent between 2010 and 2012, largely though increased usage of short sales. In FY 2013, FHA began expanding the menu of alternatives. The share of REO alternatives has grown to more than 50 percent during the last two years. The net effect of these efforts is summarized in Exhibit II-12.

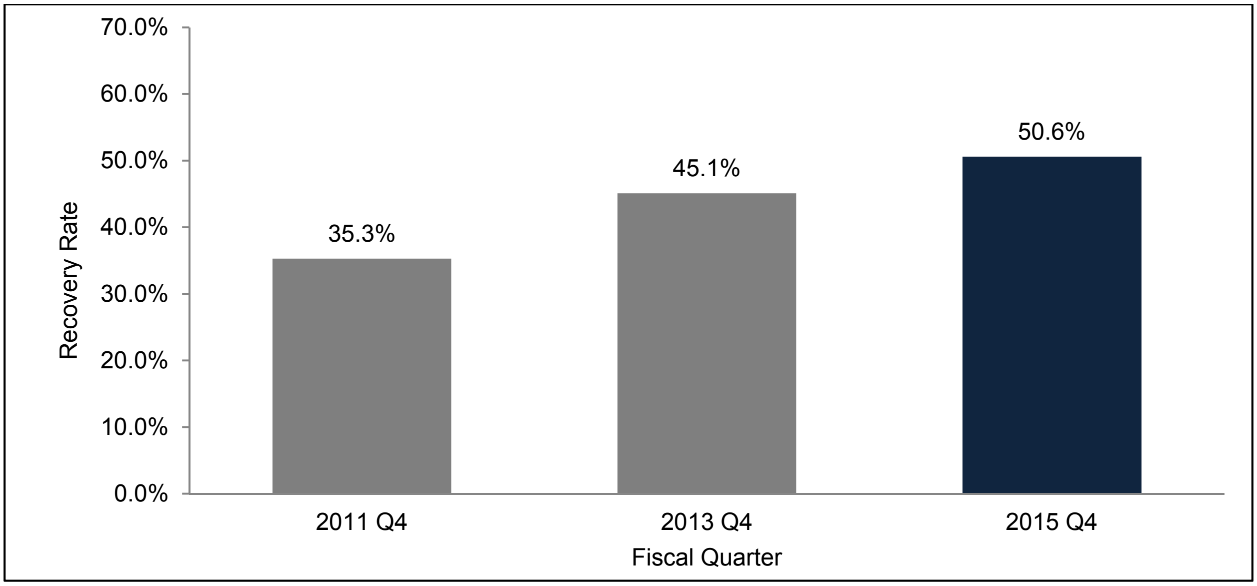
Exhibit II-12
Loss Severity and Share of Disposition by Type of Disposition Strategy



SOURCE: U.S. Department of HUD/FHA, October 2015; analysis by U.S. Department of HUD/FHA.

The success of these efforts is reflected in the rapid improvement in recovery rates. As shown in Exhibit II-13, claims recoveries have improved by 43 percent since FHA began implementing a diversified asset disposition strategy in 2013, contributing more than $3 billion to the MMI Fund during that time.

Exhibit II-13
Claims Recovery Rates

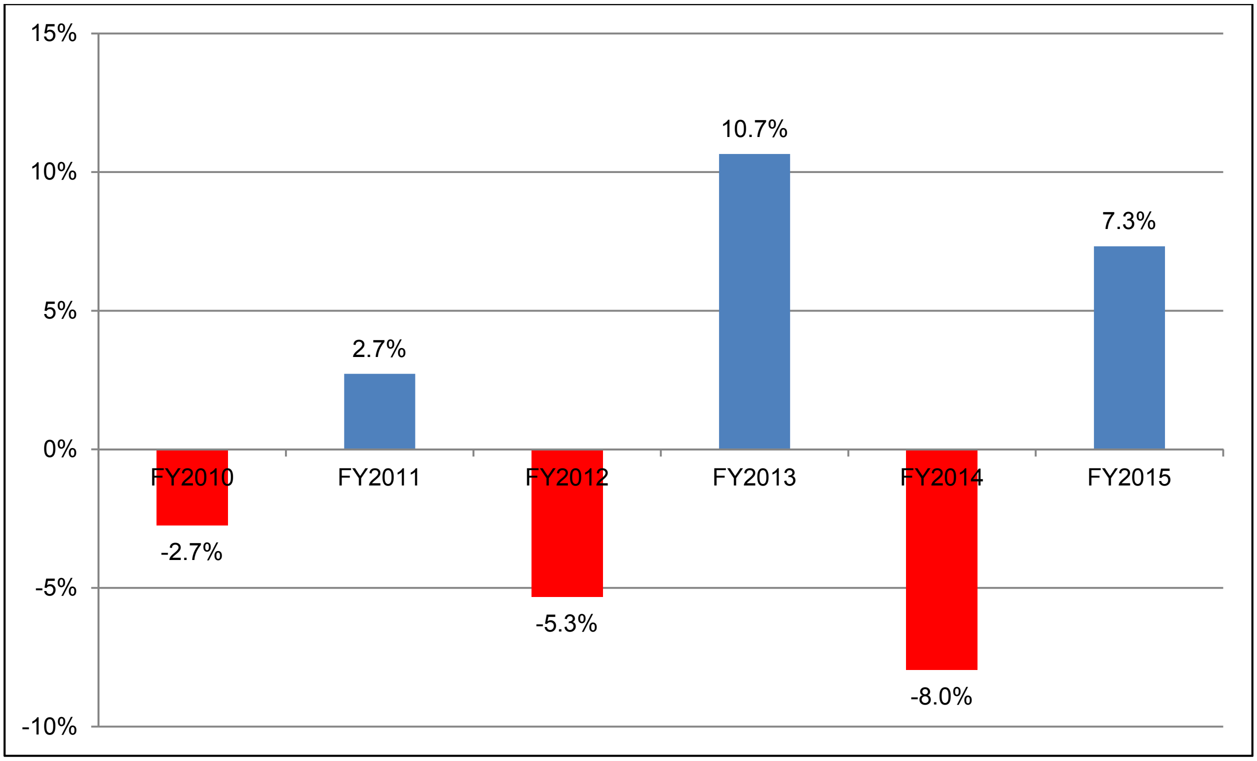


SOURCE: U.S. Department of HUD/FHA, October 2015; analysis by U.S. Department of HUD/FHA.

2. Causes of Year-Over-Year Variation in HECM Valuations

In contrast to the Forward portfolio, which has steadily improved over the last three years, HECM valuations, while strong this year, have been quite volatile. Exhibit II-14 shows the change in value of the HECM portfolio since FY 2010 as a percent of portfolio size. Note that HECM valuations have gained or lost more than 5 percent in each of the last four years.

Exhibit II-14
HECM Year-over-Year Change in Value as Percent of HECM IIF



SOURCE: FY 2010–FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

Exhibit II-15 highlights the assumptions that had the biggest impact on this year's actuarial results. House price appreciation (HPA) forecast is one of the key drivers of the value of both Forward and HECM portfolios. This exhibit shows that while the slightly more optimistic HPA forecast in FY 2015 improved the value of the Forward portfolio by $2.1 billion, that same shift improved the HECM value more than twice as much, $4.8 billion. Measured as a share of IIF, the impact a more optimistic house price forecast had on HECMs was twenty times higher than Forwards, 4.5 percent versus 0.2 percent.

Exhibit II-15
Sensitivity of Portfolio Value to Main Drivers

Reason for Improvement	Improvement ($billions)		Improvement (% IIF)	
	HECM	Forward	HECM	Forward
Improved HPA Forecast	4.8	2.1	4.5	0.2
Lower Discount Rate	4.5	0.0	4.3	0.0

SOURCE: FY 2015 Actuarial Review of the MMI Fund; analysis by U.S. Department of HUD/FHA.

Additionally, a slight decrease in the discount rate assumption improved the HECM portfolio's value by $4.5 billion, but it had practically no impact on the value of the Forward portfolio. This $4.5 billion improvement in the MMI Fund in FY 2015 largely reversed a loss of similar magnitude in FY 2014. Thus, it is conceivable that an increase in interest rate assumptions next year could offset any gains from the Forward portfolio, taking the capital ratio for the MMI Fund below 2 percent again in FY 2016. The actuarial analysis projects a 20 percent chance that the capital ratio could dip below 2 percent in FY 2016.

Two HECM characteristics are primarily responsible for the sensitivity of HECMs to changes in economic assumptions.

1. HECMs are characterized by a significantly longer Weighted Average Life than standard mortgages (over 15 years for HECMs versus about 6 years for Forwards).

2. While FHA serves solely as guarantor for the Forward portfolio, its role is closer to that of financier for HECMs over the life of the loan.

FHA is often an investor in HECM mortgages as the loans age. Fluctuations in the value of an unhedged mortgage portfolio (i.e., HECM) is larger than the swings in the value of a credit guarantee business (i.e., Forward) alone. Conceptually, this is because the primary asset for the Forward credit guarantee business is the MIP revenue stream, which equals only about 1 percent of the IIF (about $10 billion), compared to *100 percent of the IIF* (about $100 billion) for the HECM portfolio. This is consistent with actuarial analyses that suggest HECM portfolio valuations are more than 10 times as sensitive to changes in economic assumptions than are Forward valuations.

It is helpful to work through a stylistic example. Assume that a borrower owns a home outright that is valued at $200,000. This borrower can take $100,000 of equity from the home through a HECM loan in which the borrower has agreed to give up 5 percent equity in the home annually for as long as the borrower stays in the home. From the borrower's perspective, a HECM is a negatively amortizing loan, in which the principal owed grows annually at a 5 percent rate compounded. Under conditions of the loan, the borrower need not make monthly payments to pay back the loan and is allowed to remain in the home for as long as the borrower chooses to stay.

In the first stage of the HECM financing cycle, the Ginnie Mae (GNMA) investor provides $100,000 in financing in return for receiving a 5 percent return annually. The GNMA investor agrees not to receive regular periodic payments. Instead, the 5 percent accrues to principal that the borrower eventually owes. FHA guarantees the GNMA investor will receive a 5 percent return, limited to the original value of the home–$200,000 in this example.

After a number of years, the amount owed to the GNMA investor grows close to the original value of $200,000. At this point, the loan is bought out of the GNMA security and the GNMA investor receives the principal of almost $200,000 from FHA. The loan is assigned to FHA, now owner of the mortgage through the Secretary-held portfolio. It is probable, but not certain, that the value of the home has appreciated to more than $200,000 at this point. The borrower's situation remains unchanged. The person is still allowed to reside in the house indefinitely, subject to the HECM note that negatively accrues by 5 percent annually, for as long as the borrower maintains residency.

Assume this borrower stays in the house for 15 years after FHA acquires the loan from Ginnie Mae before moving on. The borrower (or the heirs) can sell the property at that time and pay FHA the amount owed, which includes principal that has accrued at 5 percent annually for 15 years. However, the accrued principal often exceeds the value of the property (i.e., HPA was less than 5 percent annually in this example), and the borrower instead chooses to turn over the property to

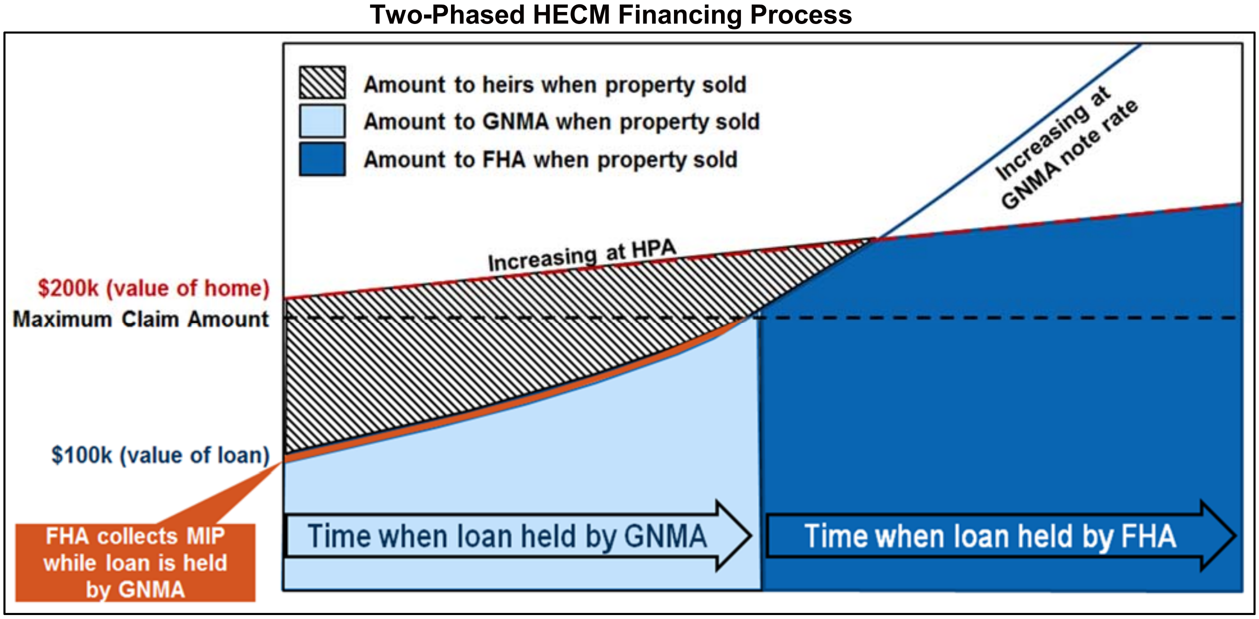
FHA. FHA would sell the property, which has appreciated at HPA minus selling expenses and repairs, to recover the $200,000 that was paid to the GNMA investor 15 years earlier.

The actuary's cash flow assumptions for the HECMs in the Secretary's portfolio indicate that the HECM portfolio has a negative net present value (NPV), but a positive nominal cash flow. Nominal cash flows are positive because FHA generally benefits from long-term HPA. The discount rate assumption used in modeling drives the NPV valuation negative when HPA minus expenses is less than long-term Treasury rates.

The 2 percent ratio is designed to protect taxpayers from losing out in a severe credit event that causes negative cash flows. However, a large part of the HECM loss potential is due to the risk that Treasury rates could rise, regardless of credit performance. In effect, setting aside reserves for losses related to rate increases would compensate tax payers for the opportunity cost of not investing in a higher-yielding Treasury bond, rather than credit losses.

In summary, HECM loans are initially financed through GNMA. FHA serves its traditional guarantor role during this time, earning MIP premiums. Once the HECM is bought out of the GNMA pool, FHA's role switches to financer and it then owns an asset that essentially earns accumulated HPA less selling expenses. Exhibit II-16 illustrates this two-phased funding process.

Exhibit II-16
Two-Phased HECM Financing Process



Of the current $105 billion HECM portfolio, the actuary projects that FHA will finance about $67 billion over the next six years, which will remain in the Secretary-held portfolio, on average, for another 12 years. This Secretary-held HECM portfolio makes the MMI Fund more sensitive to changes in long-term discount rate assumptions relative to house price assumptions.

HECMs were first included in the MMI Fund in 2009, with the IIF having grown from $28 billion to $105 billion since then. Because the HECM portfolio is projected to continue growing at a faster rate than the Forward portfolio, year-to-year HECM volatility is likely to contribute even more uncertainty to future actuarial valuations of the Fund.

* * * * * * * * * * * * * * * * * *

As FHA emerged from the economic crisis, discussions of the health of the MMI Fund rightfully focused on the prospects of the Forward portfolio. In recent years, it has become clear that the future health of the Fund also depends on the progress of the HECM portfolio.

Looking ahead, we expect that steady improvement in the value of FHA's Forward portfolio is repeatable and sustainable. Unfortunately, the future performance of HECMs is not predictable, showing almost random behavior over the last six years, largely as a result of sensitivity to seemingly small shifts in the view of future economic conditions, particularly interest rate projections. Given this extreme sensitivity, and the potential for a major shift in interest rates over the next few years, a reasonable potential exists for a future loss in the actuary's estimate of HECM's value that could exceed any gains in the Forward portfolio. For example, the actuarial analysis suggests that an upward shift in interest rates of as little as 2.5 percentage points (meaning an increase in 10-year Treasury rates to 4.7 percent, not a particularly high level by historical standards) would essentially zero out the current capital cushion.

The focus of this chapter has been the impact of HECM volatility on the reliability of *year-to-year* actuarial projections. Chapter 3 will describe the impact HECM volatility could have on capital adequacy of the MMI Fund and on Forward pricing.

III. Risk Analysis and Policy Implications

FHA's pricing, capital, and risk strategies for forward loans supports FHA's housing mission and ensures long-term solvency of the MMI Fund. Coming out of the crisis, past discussions regarding capital adequacy of the MMI Fund appropriately focused on performance of FHA's Forward portfolio. However, the impact of the HECM portfolio has increased as it has grown from $28 billion in 2009 to $105 billion in 2015. This chapter discusses:

- Impact of the recent Forward MIP reduction.
- A framework to assess capital adequacy.
- The impact HECM volatility has on Forward pricing and capital adequacy.

A. IMPACT OF THE MIP REDUCTION

The annual MIP was reduced by 50 basis points on forward loans in January 2015 to support FHA's *Blueprint for Access* initiative. This section addresses the impact of the MIP reduction on the timeframe for reaching the 2 percent capital ratio for the Forward portfolio, purchase volumes, and MMI Fund solvency. Our analysis indicates the following:

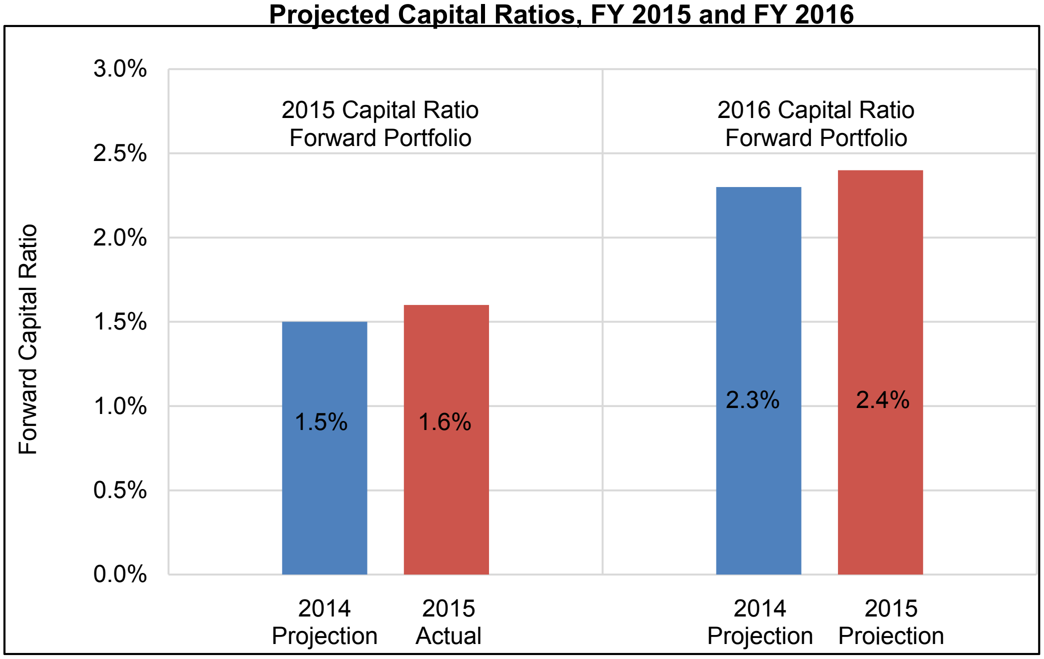
- The MIP reduction had little impact on the capital ratio. In fact, relative to last year, the actuary slightly *decreased* the projected time to achieve a 2 percent capital ratio for the Forward portfolio.
- In line with FHA projections, the MIP reduction has made it possible for over 75,000 creditworthy borrowers to purchase homes in the first eight months it was effective.
- The new MIP structure appropriately compensates for the credit risk of the Forward program, while it continues to contribute to a capital cushion.

1. Timeframe for Reaching the Two Percent Capital Ratio

Some questioned whether the MIP reduction would lengthen the time it would take for the Fund to reach a 2 percent capital ratio requirement. Given the significant impact of HECMs to the MMI Fund in FY 2015, it is difficult to distill the impact that the MIP reduction had on the entire MMI Fund. However, actuarial comparisons of the Forward portfolio in FY 2014 and FY 2015 suggest that the net impact of the MIP reduction had a neutral to slightly positive impact on the Fund.

Last year, the actuary projected that the Forward portfolio would achieve a 1.5 percent capital ratio by FY 2015. Actual performance was slightly better at 1.6 percent. The actuary's report for FY 2015 continues its forecast from FY 2014 that the Forward portfolio will reach a 2 percent ratio in FY 2016. These predictions are summarized in Exhibit III-1.

Exhibit III-1
Projected Capital Ratios, FY 2015 and FY 2016



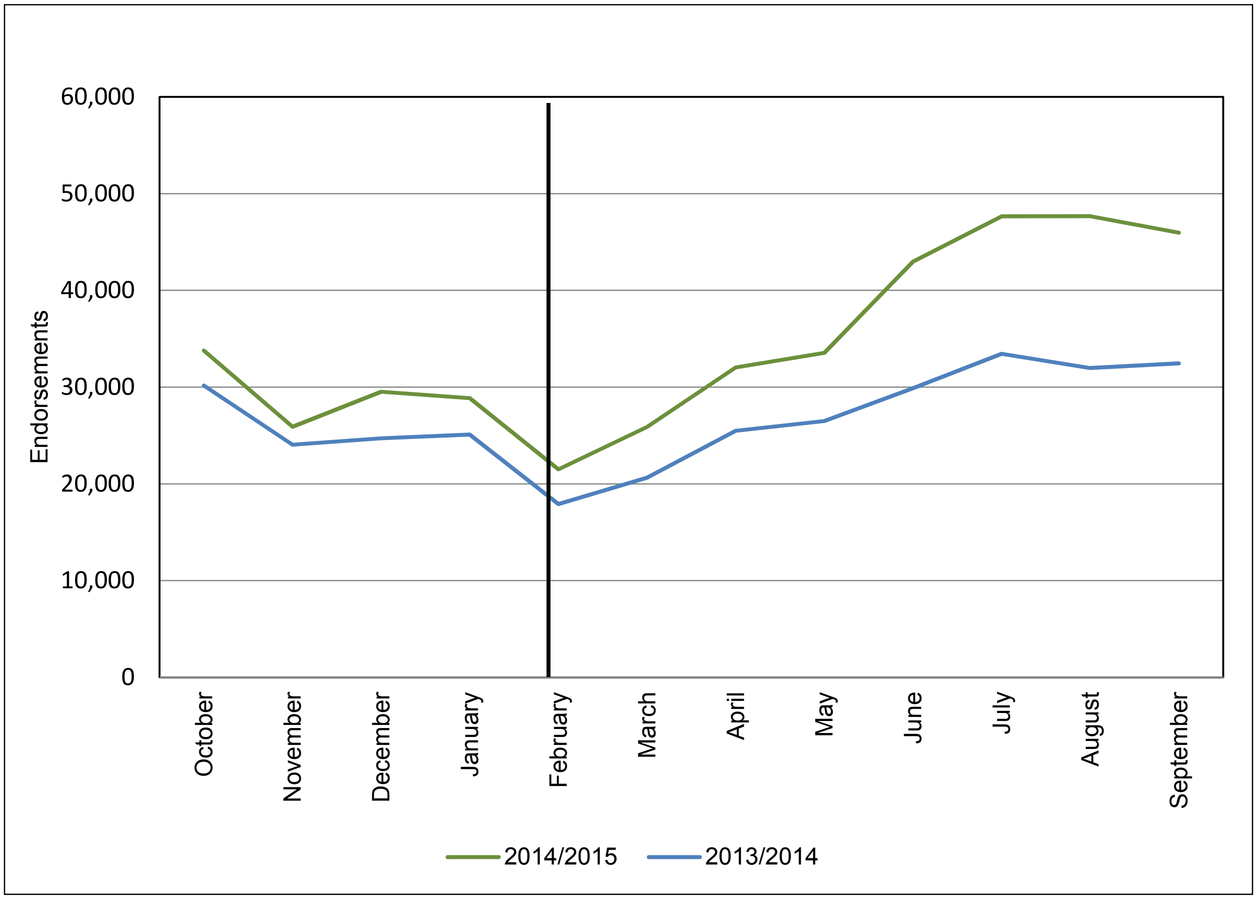
SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

2. Purchase Volumes

When the MIP reduction was announced, FHA communicated to stakeholders that the action was expected to introduce 250,000 new borrowers into the market over a three-year period, an average of roughly 83,000 per year. Purchase activity during the eight-month period following the MIP reduction implies that FHA is delivering on this commitment.

Exhibit III-2 compares year-over-year purchase endorsements for borrowers with credit scores below 680, a segment of the market that has been underserved since the economic crisis. Purchase activity for these borrowers increased by more than 75,000 loans in the eight months following the MIP reduction, which is on track, and potentially ahead of FHA's estimate of 83,000 new borrowers per year.

Exhibit III-2
Purchase Endorsement Volume for Borrowers with Credit Scores below 680

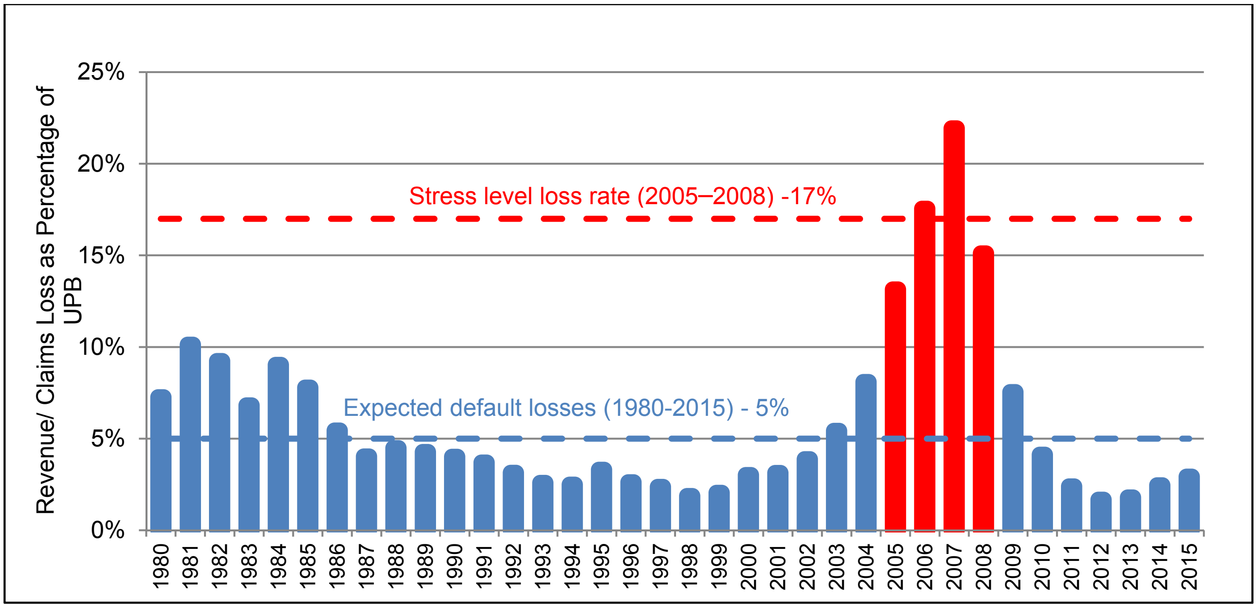


NOTE: The MIP reduction in January 2015 is not reflected in endorsement volume until March 2015.
SOURCE: U.S. Department of HUD/FHA, October 2015.

3. MMI Fund Solvency

The MIP reduction also raised concerns related to the long-term solvency of the MMI Fund. The current MIP pricing structure for forward loans appropriately covers FHA's credit risk exposure and contributes to the capital cushion. Exhibit III-3 provides the context for the two-tiered pricing structure for forward mortgages, showing historic FHA losses going back to FY 1980 with stress level losses from FY 2005–FY 2008 highlighted in red.

Exhibit III-3
Credit Losses by Vintage



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

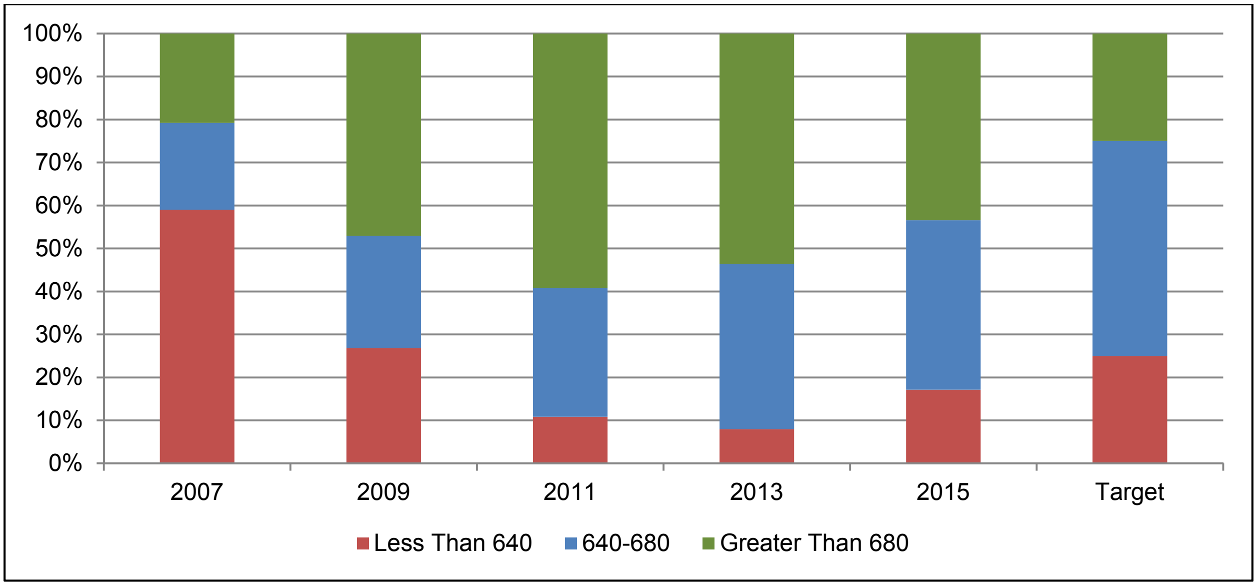
The Forward mortgage MIP pricing structure is designed to address two needs:

– **Expected loss coverage.** MIP revenue must be sufficient to cover long term FHA average losses. One can think of the MIP level that covers these losses as a "break-even" premium; this level is also a long-term MIP floor. FHA estimates average claims losses of forward loans going back to the early 1980s (excluding 2005–2008) at approximately 5 percent of the original principal balance. Note that losses for any given vintage rarely equal the "average." More typical is the pattern seen in Exhibit III-3 – more years of somewhat lower than average losses in non-recession years, interspersed with fewer years of significantly higher than average losses. Thus, the breakeven component compensates for losses incurred in mild recessions.

– **Contribution to a capital cushion**. The 2 percent reserve provides a capital cushion to credit losses that would occur due to a future housing crisis, above and beyond what is already in place to pay expected claims. By definition, breakeven pricing cannot consistently fund a capital reserve. This means MIP pricing needs to exceed breakeven at some point to contribute to a capital cushion.

FHA's *current* risk profile suggests a credit loss expectation lower than 5 percent, as the share of borrowers with lower risk credit scores is higher than historic norms. Over time, as the benefits of *Blueprint for Access* initiatives are fully realized, we expect FHA's risk profile to shift toward its more traditional borrower base, illustrated in Exhibit III-4 below.

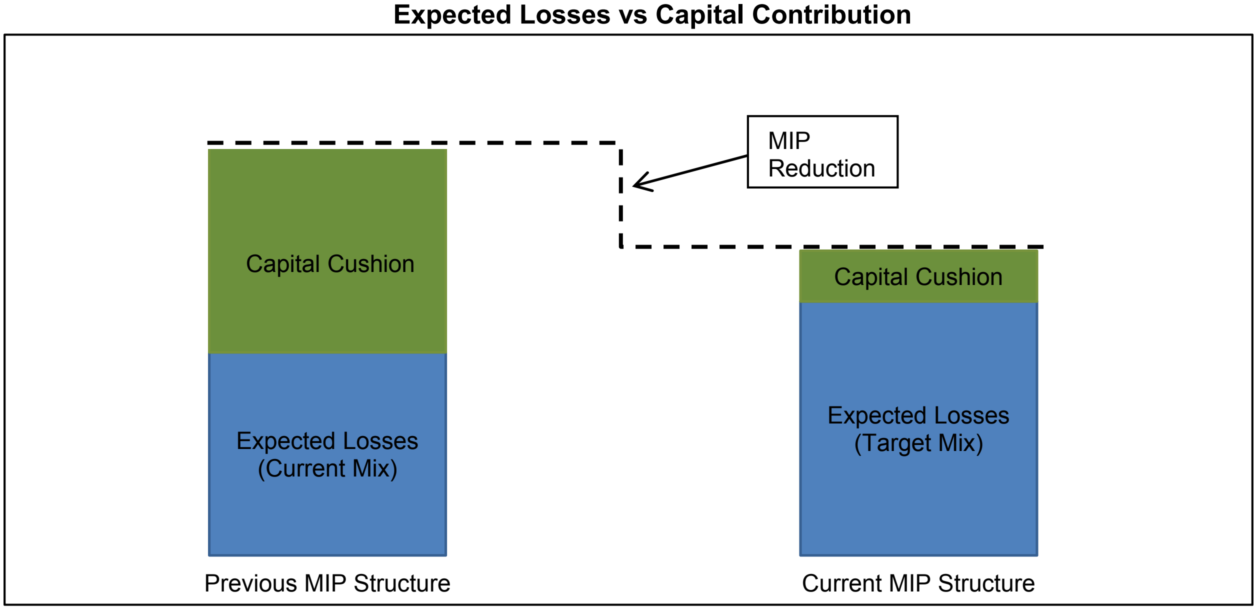
Exhibit III-4
FHA Share by Credit Score Band



SOURCE: U.S. Department of HUD/FHA, October 2015.

The MIP decrease did not compromise the capital cushion or affect FHA's ability to pay expected claims. The current MIP pricing structure for forward loans appropriately covers current risk, anticipates a shift to FHA's more traditional borrower base, and contributes to the capital cushion, as illustrated in Exhibit III-5.

Exhibit III-5
Expected Losses vs Capital Contribution



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

B. CAPITAL ADEQUACY FOR THE FORWARD PORTFOLIO

Capital adequacy is one important driver of Forward MIP pricing, as FHA funds the capital reserve through MIP revenue in excess of expected losses. Conceptually, capital accretion would continue until the MMI Fund has accumulated sufficient capacity to protect from stress-level credit losses that would occur in the next housing crisis. Once the Fund is fully capitalized, the MIP price structure could be reduced to a floor that would cover expected losses only.

While achieving the 2 percent capital ratio target represents a crucial milestone for FHA, managing the Fund goes beyond achieving a minimum capital ratio at a particular point in time. Prudent risk management practice should overlay the statutory capital requirement with a risk management approach that would take into account the health of the economy, and implications of the sensitivity of the fund to small changes in interest rates. For example, the HECM portfolio lost 8 percent of its value in FY 2014—largely because of a slight uptick in the discount rate assumption—while the economy was in the midst of a recovery. This observation would suggest that a 2 percent capital cushion for HECMs would be insufficient in a severe economic downturn.

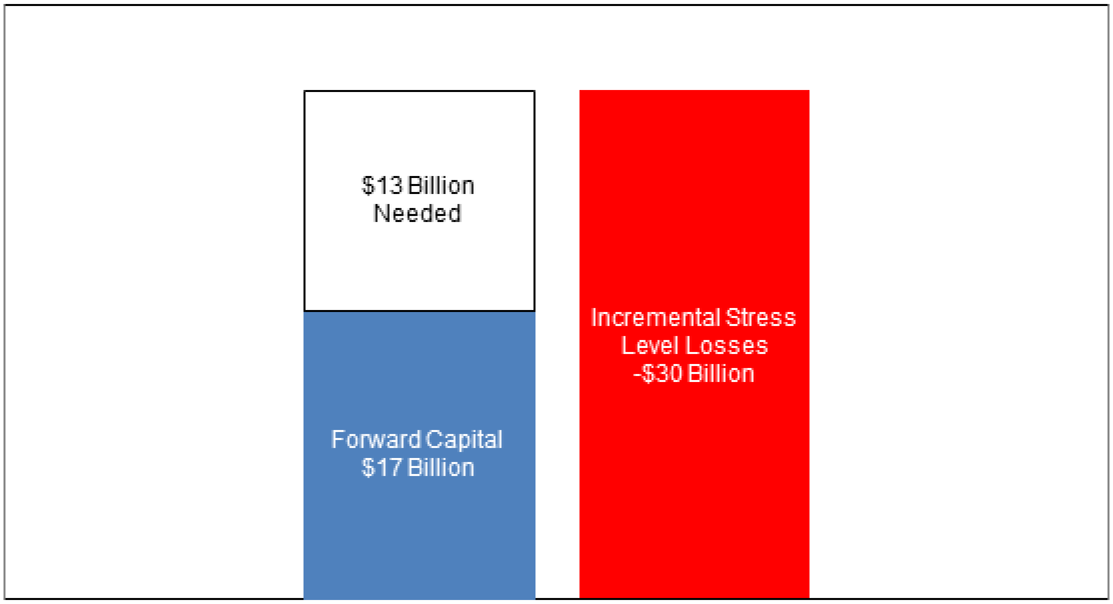
A standard-practice approach would be to first estimate the dollar amount required to cover estimated stress-level losses; a ratio would thus be a derived result, not the targeted outcome. It may be helpful to first review the formula for Federal Credit Reform Act of 1990 (FCRA) Capital:

FCRA Capital = (Capital Resources + NPV MIP – NPV Losses)

The Independent Actuarial Report provides one approach to assess capital adequacy, as the actuary's methodology solves for minimum capital resources required to prevent the capital ratio from going negative for any one of 100 possible scenarios. The following example illustrates this actuarial method (and is for explanatory purposes only).

The average of the actuary's five worst-case scenarios roughly corresponds to the stress experienced by the Forward portfolio during the last economic crisis. The stress scenario results in incremental losses of about $30 billion above the current expected losses scenario (i.e., the average losses one observes over long periods of time). The actuarial analysis puts the current capital position of the Forward portfolio at $17 billion. This implies the fund needs an additional $13 billion to avoid going negative again in the event of another 2007–2010 type economic crisis (Exhibit III-6).

Exhibit III-6
Claims Paying Capacity vs Stress Level Losses
Forward Portfolio



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

To summarize, Exhibit III-6 shows:

- The capital ratio for the *Forward portfolio* currently is 1.6 percent.
- The Forward portfolio needs to accumulate another $4 billion in capital to meet the 2 percent capital ratio.
- The actuarial results show that the Forward portfolio would need another $9 billion over the statutory minimum to withstand the level of losses sustained in the last crisis.

The actuary projects that the Forward portfolio could accumulate enough capital to reach $30 billion within one to two years.

The preceding discussion illustrates how FHA could apply modern actuarial techniques to managing the Forward portfolio. But the discussion also segregates the health of the Forward portfolio from the remainder of the MMI Fund. Should HECMs put MMI capital at risk, they have implications for Forward mortgage pricing.

C. HOW DOES HECM VOLATILITY AFFECT FORWARD STRATEGY?

Analysts generally use the MMI capital ratio as a proxy for the health of the Forward portfolio, primarily because the Forward sub-portfolio makes up $1.0 trillion of the $1.1 trillion MMI portfolio. However, the actuarial value of HECM capital has swung dramatically over the last four years; these swings have led HECMs to have an outsized impact on the value of the MMI Fund.

The capital ratio for the HECM portfolio stands at 6.5 percent, which exceeds the statutory minimum 2 percent capital ratio. A brief review of historical HECM valuations suggests that significantly more than 2 percent capital is needed for the HECM portfolio to keep the MMI Fund reliably above 2 percent, if it remains in the MMI portfolio.

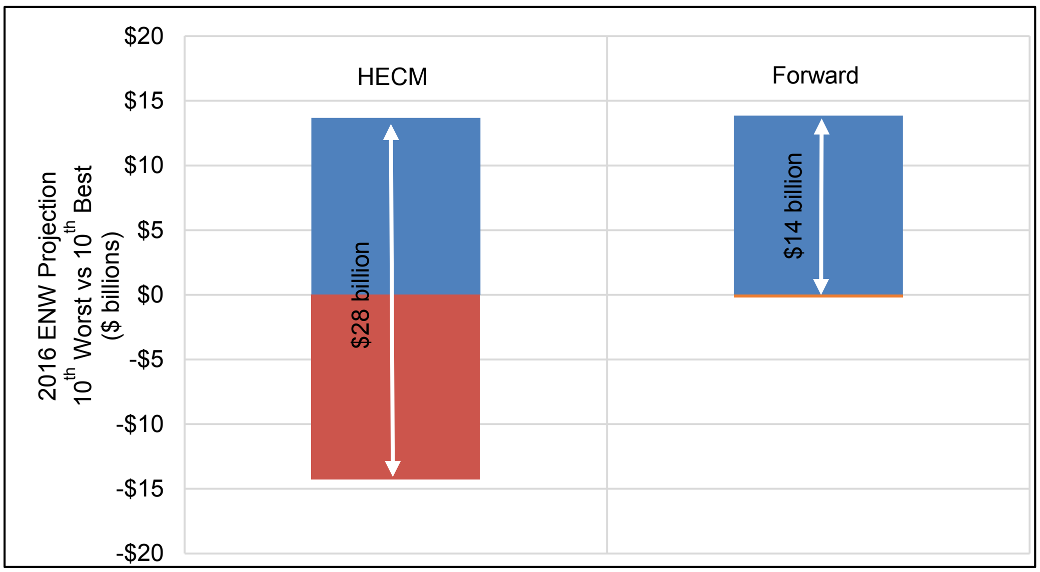
Volatility of the HECM portfolio affects decisions for the Forward portfolio to the extent that:

- The overall MMI capital ratio serves as a proxy for the health of the Forward portfolio.
- Forward MIP pricing strategy is driven, at least in part, by the health of the overall MMI Fund.
- HECM volatility has a large, unpredictable impact on the MMI capital ratio.

An example of how volatile HECM results can affect conclusions regarding the health of the Forward portfolio business is provided by the actuary's 100 path scenario analysis. The results of 10th best and 10th worst scenarios are published in the actuary's documentation. By definition, there is an 80 percent probability that the actual value of the portfolio next year will fall between the two values corresponding to the 10th best and 10th worst path.

The 80 percent range of projected FY 2016 values for HECMs and Forwards is shown in Exhibit III-7. The range of values between the 10th best and 10th worst scenarios for HECMs is projected at $28 billion, twice that of the Forward portfolio.

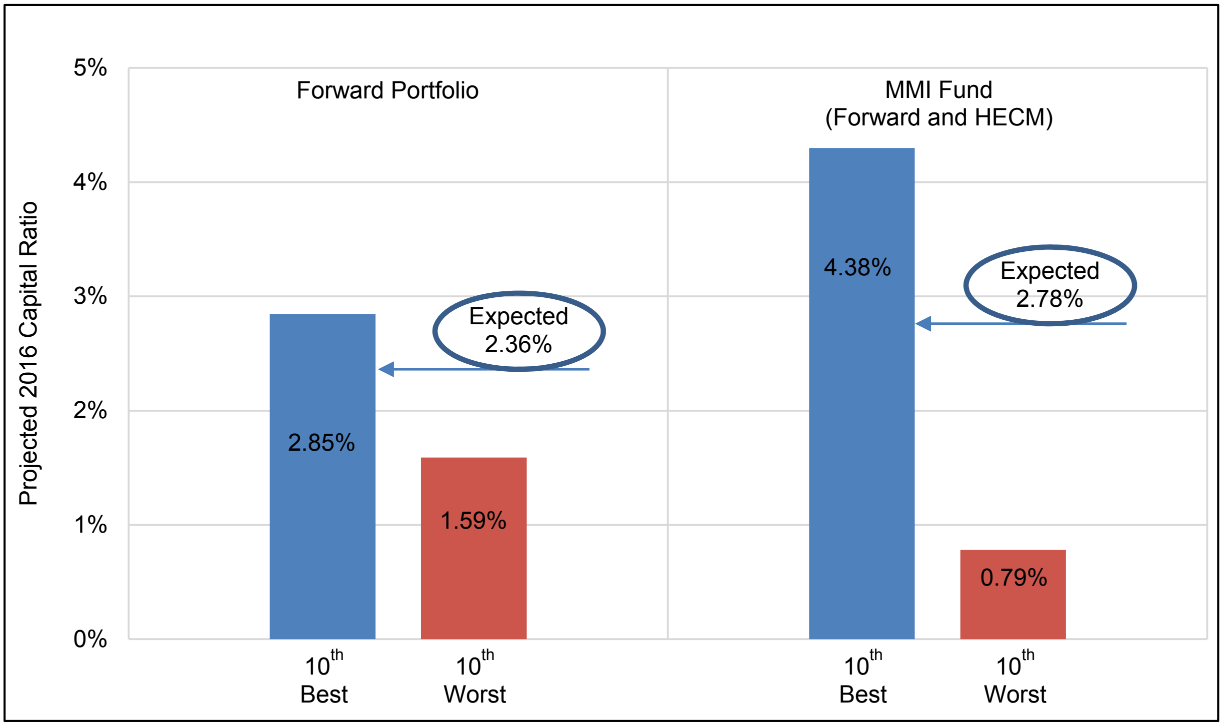
Exhibit III-7
Range in Economic Net Worth
10th Best vs 10th Worst Scenarios
Forward and MMI Portfolios



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

The impact on the capital ratio of the MMI Fund is significant. Exhibit III-8 compares the capital ratios of the Forward portfolio exclusively to the ratio of the MMI Fund as it is now calculated, with Forward and HECM portfolio combined.

Exhibit III-8
Range in Capital Ratio
10th Best vs 10th Worst Scenarios



SOURCE: FY 2015 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

In a good economy (10th best scenario), Forwards are projected to perform solidly, with their capital ratio rising to 2.85 percent, somewhat higher than the expected 2.36 percent ratio projected for FY 2016. The performance of the MMI Fund, on the other hand, would increase to 4.38 percent. This would more than double from the FY 2015 level of 2.07 percent, potentially leading to a conclusion that the Fund is over-capitalized and a large reduction in the Forward MIP is warranted.

Alternatively, in a bad economy (10th worst scenario), Forwards are projected to slightly underperform, but hold their value at today's level and largely maintain their current capital ratio at 1.6 percent. The capital ratio of the MMI Fund, on the other hand, would fall to 0.79 percent, less than half the FY2015 level, sending a signal that the Fund is undercapitalized, potentially leading to a conclusion that the Fund is insufficiently capitalized and a large increase in the Forward MIP is warranted.

If policymakers use the MMI capital ratio as a proxy for the health of the Forward portfolio, including HECMs in the MMI Fund could influence the perceived performance of Forwards. Forward performance will be perceived as being better than it actually is in a good economy, and perceived as being worse than it is in a bad economy. Any capital cushion "created" by HECMs in a good economy will be offset by losses to HECMs in a down economy, when capital will be most needed to buffer losses in the Forward portfolio.

Combining the two loan offerings in a single MMI Fund complicates evaluating the finances of these very different programs. In addition, co-mingling Forwards with the volatility of the HECM portfolio seems inconsistent with the goal of providing a stable presence in the mortgage market.

It is not clear that a fundamental reason exists to combine the Forward portfolio and HECM loans when assessing the MMI Fund.

IV. FHA Single Family Policy Priorities

Policy priorities for Single Family programs are largely consistent with those of previous years, with the addition of programs in FY 2016 that bring an increased focus on energy efficiency. This section highlights FHA's accomplishments over the past year in these areas, and briefly discusses priorities for FY 2016.

A. PURSUE ACTIONS THAT SIMULTANEOUSLY INCREASE ACCESS TO CREDIT AND STRENGTHEN THE MMIF

In FY 2014 and FY 2015, FHA worked diligently to increase access to credit while strengthening the MMI Fund. Over the past two years FHA has introduced a number of initiatives towards this goal:

1. New Quality-Assurance Taxonomy

Throughout FY 2015, after considering comments solicited from stakeholders, FHA refined a new Quality Assurance Defect Taxonomy to simplify and more effectively and clearly communicate quality control results to FHA lenders. FHA developed a framework around three key components: identifying defects, assessing the severity of the defects, and focusing on the sources and causes of the defects. During FY 2016, FHA will implement systems changes and build the Loan Review System (LRS) that will allow the new Quality Assurance Taxonomy to be implemented.

2. Publication of New Single Family Handbook

FHA will continue to work toward finalizing the publication and implementation of all sections of its new Single Family Handbook. On September 14, 2015, FHA made effective most sections of the Handbook, and thus largely completed a core component of its goal to expand access to mortgage credit. Working collectively with mortgagees and other stakeholders, the following sections were made effective:

1. *Doing Business with FHA–Lenders and Mortgagees*
2. *Doing Business with FHA–Other Participants in FHA Transactions for appraisers*
3. *Origination through Post-Closing/Endorsement for Title II Forward Mortgages*
4. *Appraiser and Property Requirements for Title II Forward and Reverse Mortgages*
5. *Quality Control, Oversight and Compliance–Lenders and Mortgagees*
6. *Quality Control, Oversight and Compliance–Other Participants in FHA Transactions for appraisers*

During FY 2016, FHA will finalize the remaining sections of the Handbook, which will allow mortgagees and other stakeholders to benefit from a consolidated, consistent, and comprehensive set of policies.

3. Supplemental Performance Metric

Finally, FHA enhanced its quality assurance practices in FY 2015 by implementing the Supplemental Performance Metric. The Metric compares lender performance to a targeted risk mix and default rate, weighting defaults within three credit score bands. This creates a lender's weighted average default rate that is compared to an FHA target rate to derive a Supplemental Performance Metric Score.

It will be used as an additional compensating factor and will help paint a clearer picture and provide a more comprehensive analysis of a lender's performance when FHA is considering further action. Implementation of the Supplemental Performance Metric in FY 2015 is a substantial achievement that reflects FHA's belief that a number of factors are relevant to, and indicative of, a lender's performance, and that a lender's story cannot be summarized by its Compare Ratio alone.

4. Servicing Updates

In FY 2015, FHA focused its servicing efforts on crafting new policies that better protect the MMI Fund and position FHA as a better business partner. The following actions are being taken by FHA to address these issues:

– *Establish reasonable diligence timelines and penalties*. FHA worked closely with the Office of General Counsel to address servicers' concerns about the disparity between failure to meet a foreclosure timeline and the associated penalty; penalties for missing the first legal action dates are now more equitable. FHA also published updated guidance addressing foreclosure timeframes.

– *Expand automatic extensions for First Legal Action (FLA) to incorporate new loss mitigation requirements*. FHA identified a need for new extensions to accommodate recent changes in loss mitigation and regulatory policy (e.g., CFPB). FHA subsequently published policy which added two new extensions, while also providing a comprehensive listing of those extensions already available to servicers. FHA also provided servicer training to better educate servicers on the subject of extensions.

– *Refine Conveyance Policies Related to Property Disposition*. FHA identified the need for clarity surrounding conveyance requirements. To address this issue, FHA will assess the feasibility of a Pre-Conveyance Inspection Pilot that would help servicers ensure compliance with FHA's property conveyance standards and aid in reducing costly reconveyances to servicers.

– *Increase allowable repair and relocation expenses*. FHA worked with the Office of Management and Budget (OMB) to determine if it was feasible to increase these allowances without adversely impacting the financial soundness of the MMI Fund and, ultimately, published policy addressing these issues.

– *Expand Claims without Conveyance of Title (CWCOT) and "Second Chance" procedures*. The CWCOT pilot allows mortgagees to sell properties at a certain percentage of fair market value (rather than unpaid principal balance), thus increasing the likelihood that properties would sell to third parties and reducing costly conveyance claims for FHA. "Second Chance" allows mortgagees to continue attempting to sell properties during the time between the formal foreclosure sale and conveyance of the property to HUD. In the first six months following the formal launch of CWCOT and its companion program, now referred to as "Post-Foreclosure Sales Efforts," approximately 23 percent of properties are thus not subject to costly conveyance claims.

5. **Condominium Updates**

The Housing and Economic Recovery Act (HERA) of 2008 moved the insurance of a single unit condominium from Section 234 to Section 203 of the National Housing Act. HERA also provided authority to HUD for issuance of administrative actions, e.g., Mortgagee Letters, as a conduit for providing condominium guidance, as Section 203 does not contain regulatory requirements for condominium projects or unit approval. FHA has been working diligently to develop policy to provide guidance to the industry as a result of these legislative changes.

During FY 2016, FHA will revise its condominium guidelines through a mortgagee letter and through rulemaking.

– *Mortgagee Letter*. In November 2015, temporary condominium guidance was issued that provided (1) notice of revised data used to calculate owner-occupancy percentages, (2) expansion of eligible condominium project insurance coverage, and (3) revised requirements for obtaining condominium project recertification. The requirements of this mortgagee letter are applicable to all Title II programs, including the HECM insurance program. FHA anticipates that the issuance of these additional temporary provisions will increase the pool of condominium projects eligible for FHA approval, thus increasing affordable housing options for first-time and low-to-moderate income homebuyers.

– *Proposed Condominium Rule*. This will implement HUD's authority under the single family mortgage insurance provisions of the National Housing Act to insure one-family units in a multi-family project, including a project in which the dwelling units are attached, or are manufactured housing units, semi-detached, or detached, and an undivided interest in the common areas and facilities which serve the project. The rule will codify requirements for the approval of condominium projects for FHA insurance, and will propose a method by which certain approval standards can be varied to meet market needs while providing for public comment where appropriate. Currently, single family condominium project approval is provided under HUD's Condominium Approval and Processing Guide and related mortgagee letters.

B. PURSUE ACTIONS TO INCREASE ENERGY EFFICIENCY

FHA will work during FY 2016 to develop and promote energy-efficiency programs to help consumers save money on energy costs for their homes. The additional costs of many energy-efficiency measures may pay for themselves within the life of the equipment, or even the life of a mortgage. However, despite the benefits, consumers don't always invest in the most energy-efficient equipment or products when they buy or renovate a home, for two primary reasons: they do not have the funds to cover the initial cost of energy-efficient measures, and they lack the information about the most cost-effective improvements. These initiatives are aimed at solving those issues.

1. 203(k)

FHA will promote existing programs that can be used for energy-efficiency, particularly 203(k), which allows borrowers to use mortgages to purchase or refinance a home along with energy efficiency improvements (such as insulation, double pane windows, etc.)

2. PowerSaver

FHA is significantly enhancing its energy-efficiency second-lien program, known as PowerSaver during FY 2016. Homeowners will be able to use FHA's PowerSaver to obtain a loan for clean energy and/or energy efficiency improvements. FHA is pursuing updates to the previous PowerSaver program to make it easier for homeowners to borrow up to $25,000 for energy efficiency improvements.

Key features of FHA's PowerSaver 2.0 Home Improvement loan program being considered are:

- Flexible underwriting that recognizes the reduced cost of utilities for energy efficient homes.
- Increased flexibility for homeowners to control the disbursement of loan funds to the contractor, cutting red tape.
- Increased flexibility to permit contributions to reduce out-of-pocket expenses and/or reduce borrower interest rates, making improvements more affordable for homeowners.

3. Energy-Efficient Homes and Home Energy Score

During FY 2016, FHA will implement new guidelines for FHA's Energy Efficient Home (EEH) program. This guidance was published on September 30, 2015 and will be effective January 25, 2016. The new standards for EEH recognize the cost savings of an energy efficient home when qualifying a borrower, and complement FHA's robust set of existing energy efficiency underwriting flexibilities and programs. EEH stretch ratios are permitted for FHA's Title II forward mortgage products and programs, and make it easier to manually qualify borrowers on a purchase, refinance, or rehabilitation of a home with energy efficient components. The score is the equivalent of an automobile's "miles per gallon" label for homes. The score measures the energy efficiency of homes on a scale of 1 to 10. FHA will provide a two-percentage-point "stretch ratio" for FHA-insured mortgages on homes that achieve a score of at least six. This means that FHA borrowers will be able to borrow slightly more when they buy or refinance a home with an above-average Home Energy Score.

4. Property Assessed Clean Energy

FHA will allow homeowners to benefit from energy efficiency improvements while preserving the marketability of properties with Property Assessed Clean Energy (PACE) loans. FHA will make financing available for single family homes with existing subordinated PACE loans provided they meet certain conditions. Under PACE programs, property owners receive financing for energy efficiency upgrades, which are repaid as a property tax assessment for up to 20 years. FHA will provide guidance to lenders during 2016 that will outline the conditions under which FHA-insured mortgages may be used to finance properties with existing PACE liens.

C. PURSUE ACTIONS TO STRENGTHEN THE HECM PORTFOLIO

Exhibit IV-1
Actions Taken to Stabilize the HECM Portfolio

Actions taken to improve HECM program in FY 2015

1. The HECM Financial Assessment and Property Charge Set Aside policy was implemented for case numbers assigned on or after 04/27/15.
2. Additional policies related to ineligible non-borrowing spouses were implemented for case numbers assigned on or after 8/4/15.
3. Implemented policy for eligible non-borrowing spouses on legacy book of business (case numbers assigned prior to 8/4/15).
4. Implemented HECM Due and Payable Policy with detailed processes and timelines.
5. Implemented HECM Loss Mitigation Policy for Tax and Insurance Defaults.
6. Extensive system enhancements, industry outreach, and training to support the new policies.
7. Development of a Proposed Rule codifying multiple policy changes made in 2014 and 2015 under the Reverse Mortgage Stabilization Act that was signed into law in August 2013.

Additional actions in progress

1. Complete Proposed Rule clearance and publication.
2. Complete the HECM Handbook drafting/review process and publication.
3. Update and publish the Financial Assessment and Property Charge Guide.
4. Continue to closely monitor performance related to the many changes implemented over the last few years to assess impact of the changes and identify areas that may require adjustment based on those findings.

The *Annual Report to Congress Regarding the Financial Status of the Mutual Mortgage Insurance Fund Fiscal Year 2014* described changes implemented in FY 2014 to reduce risk to the Mutual Mortgage Insurance Fund arising from HECMs by reducing large draws at closing and increasing use of the Adjustable Rate HECM (ARM HECM). Policy changes supporting that goal included:

- Limiting the amount that borrowers can draw at closing and introduction of an initial 12-month disbursement period for ARM HECMs.
- Revising the MIP structure for borrowers who elect an initial disbursement that exceeds 60 percent of the Principal Limit. The initial MIP for borrowers who elect an initial disbursement of 60 percent or less of the Principal Limit is 0.50 percent, versus 2.50 percent for borrowers who seek an initial disbursement that exceeds 60 percent of the Principal Limit.

- Introducing new Principal Limit Factors, including factors for eligible non-borrowing spouses under 62 who became eligible for a due and payable deferral period allowing them to remain in the home after the death of the mortgagor.

Two years of data suggest that these changes are achieving the desired results.

- The mix of Fixed Rate/Adjustable Rate originations has shifted.
  - Between FY 2010 and FY 2012, the mix was 70% Fixed Rate and 30% Adjustable Rate.
  - In FY 2013, the mix was 61% Fixed Rate and 39% Adjustable Rate.
  - In FY 2014, the mix had shifted to 19% Fixed Rate and 81% Adjustable Rate.
  - In FY 2015, the mix was 16% Fixed Rate and 84% Adjustable Rate.

- Initial draw patterns have also changed significantly.
  - In 2013, 46% of borrowers drew 60% or less of the available HECM proceeds at close compared to 65% of borrowers in 2015.
  - Fixed Rate loans continue to have draws in the range of 90% of the Maximum Claim Amount, which likely reflects FHA requirements to pay off mandatory obligations, including high existing mortgages.

- Preliminary data on draw patterns show that limiting draws during the first 12 months of the loan (a policy implemented in FY 2014) does not lead to larger draws after the first 12 months. This suggests that reducing the amount borrowers can take on early improves their capacity to use home equity when they might most need it.

In 2015, additional changes were implemented to reduce risks related to borrowers' ability to be successful under the program:

- Financial Assessment and Property Charge policies apply to HECM case numbers assigned on, or after, April 27, 2015. Extensive industry outreach and training have been, and continue to be, critical to effective execution. The objective of these policies is to determine the capacity of borrowers to meet their documented financial obligations and comply with the HECM provisions. Property Charge Set Asides protect the borrower's ability to make required tax and insurance payments when borrowers use HECM funds to supplement income, and the Financial Assessment assesses whether the HECM is a sustainable solution for the borrower.

- Recently published HECM Servicing Policies provide clear and expanded guidance to servicers on due and payable requirements and also expanded loss mitigation options for HECM transactions. Policies to address issues related to non-borrowing spouses, which provided a deferral to mortgages being due and payable for eligible non-borrowing spouses, allow those spouses to stay in the home after the death of the last remaining mortgagor. This policy change addressed an issue that had been the subject of much discussion, litigation and concern, and was well received by industry and the public.

Appendix A: Summary of Selected FHA Policy Changes Since 2009

1. **Mortgage insurance premium (MIP) changes and adjustments to upfront and annual MIP relationship (Forward mortgages)**
   a. Mortgagee Letter effective January 12, 2010
      i. Increased upfront MIP to 2.25%
   b. Mortgagee Letter effective October 4, 2010
      i. Lowered upfront MIP to 1%
      ii. Raised annual MIP by 30 basis points
   c. Mortgagee Letter effective April 18, 2011
      i. Increased annual MIP by 25 basis points
   d. Mortgagee Letter effective April 9,2012
      i. Increased upfront MIP from 1% to 1.75%
      ii. Increased annual MIP by 10 basis points
   e. Mortgagee Letter effective June 11, 2012
      i. Increased annual MIP for loans in excess of $625,500 by 25 basis points
   f. Mortgagee Letter published January 31, 2013
      i. Effective April 1, 2013: Increased annual MIP by 10 basis points for loans below $625,500, and 5 basis points (maximum permitted by law) for loans at or above $625,500
      ii. Effective June 3, 2013: Eliminated the automatic cancellation of annual MIP for most loans when they reach 78% of their original value
   g. Mortgagee Letter effective January 26, 2015
      i. Decreased annual MIP by 50 basis points for nearly all Title II forward mortgages, with terms greater than 15 years.

2. **New down payment requirements**
   a. Mortgagee Letter effective October 4, 2010
      i. Loans to borrowers with a credit score of 579 or lower require a minimum 10% down payment
      ii. Loans to borrowers with a credit score of 580 or above require current minimum 3.5% down payment
      iii. Established minimum credit score of 500
   b. Federal Register Notice published February 6, 2013
      i. Loans to borrowers seeking loans above $625,500 require a 5% down payment
   c. Mortgagee Letter effective July 1, 2013
      i. Offered guidance on required documentation as evidence of borrower's minimum cash investment

3. **Enhanced underwriting requirements**
   a. Mortgagee Letter effective January 1, 2010
      i. Modifications to streamline refinance documentation requirements
      ii. New appraisal standards
   b. Mortgagee Letter effective April 1, 2012

   i. Updated documentation requirements for self-employed borrowers
   ii. Offered new guidance on disputed accounts
   iii. Expanded the definition of family members for identity of interest transactions
c. Mortgagee Letter published January 31, 2013
   i. Required that borrowers with credit scores below 620 and debt-to-income ratios over 43% subject to manual underwriting
   ii. Final Federal Register Notice published December 11, 2013, outlining manual underwriting requirements
d. Mortgagee Letter effective October 15, 2013
   i. Amended guidance on collections and disputed accounts, and clarified guidance on judgments
e. Mortgagee Letter effective August 15, 2013 through September 30, 2016
   i. Provided guidance to ensure that borrowers who have experienced financial hardship due to extenuating circumstances and have recovered are given the opportunity to be fully evaluated if foreclosure was a direct result of the hardship. Borrowers are required to complete housing counseling and to be financially stable for more than 12 months (Back to Work)
f. Mortgagee Letter effective January 1, 2014
   i. Provided notice of FHA’s single family loan limits for Title II Forward Mortgages and Home Equity Conversion Mortgages and provides loan limit instructions for streamline refinance transactions without an appraisal
g. Mortgagee Letter effective January 30, 2014
   i. Expanded FHA’s acceptance of electronic signatures, which was previously limited to third party documents included in the case binder for mortgage insurance endorsement
h. Mortgagee Letter effective April 21, 2014
   i. Provides policy guidance for revised manual underwriting requirements published in a Federal Register Notice on December 11, 2013
   ii. Explains maximum qualifying ratios for manually underwritten loans, and revises and clarifies the compensating factors that lenders must cite in order to exceed FHA’s standard qualifying ratios for these loans
   iii. Also explains new reserve requirement for manually underwritten loans on one and two unit properties
   iv. Not applicable to streamline refinances, short refinances, HECM, or Title I
i. Mortgagee Letter effective June 26, 2016
   i. Announced implementation of Electronic Appraisal Delivery (EAD) portal and provided guidance to delivering appraisals through the new platform
j. Mortgagee Letter effective January 25, 2016
   i. Updated FHA’s Energy Efficient Homes (EEH) program, and adds the use of the Home Energy Score option for mortgages on existing construction homes.

4. New Consolidated Single Family Policy Handbook

a. Origination through Post-Closing/Endorsement section published September 30, 2014
   i. Consolidated origination, processing and underwriting guidance for the standard 203(b) FHA insured mortgage as well as FHA’s special programs, such as Hawaiian Homelands, Disaster Areas, and Refinances.

b. Appraiser Property Requirements, 203(b) Requirements and Consultant Requirements sections, Doing Business with FHA and Quality Control sections for Mortgagees and Appraisers published on March 18, 2015
    i. Provided consolidated appraisal requirements for all Title II mortgages, guidance on mortgagee approval and recertification requirements and underwriting guidance on 203(k) mortgages
c. Servicing for Title II Forward Mortgages section published on June 24, 2015
    i. Consolidated servicing requirements for Title II forward mortgages
d. Nonprofits, DE Underwriters, 203(k) Consultants as parts of the Other Participants sections; HUD REO section in the Origination section published on August 26, 2015
    i. Consolidated guidance on approval and program standards for non-profits, 203(k) consultants and Direct Endorsement Underwriters.
    ii. Provided revised requirements for financing HUD REO properties

5. Changes to the HECM Program

a. Mortgagee Letter effective October 4, 2010
    i. Introduced HECM Saver, which provided a lower upfront premium (.01%) and a lower max principal limit
    ii. Increased annual MIP from .50% to 1.25%
    iii. Adjusted the HECM Principal Limit Factors, resulting in lower maximum principal limits
b. Mortgagee Letter published January 3, 2011
    i. Provided detailed guidance regarding the property charge loss mitigation requirements for HECM loans
c. Mortgagee Letter published January 30, 2013
    i. Consolidated the fixed-rate Standard program into the fixed-rate Saver, limiting the amount borrowers can draw
d. Congress passed the Reverse Mortgage Stabilization Act in August 2013 giving FHA the authority to make changes to help reduce risk
e. Mortgagee Letter published September 3, 2013
    i. Implemented a new limit on initial draws during the first 12 months of the loan term and a new single lump sum initial draw limit at origination (effective September 30, 2013), a required financial assessment and required property charge set aside. Although policy was published, HUD decided to update the policy to reflect comments received in response to a Federal Register notice that was posted with the Mortgagee Letter. The updated policy was published in November 2014.
    ii. Eliminated the fixed standard and fixed HECM Saver programs and introduced a new Fixed Rate and ARM product with reduced Principal Limit Factors and new upfront mortgage insurance premium structure based on percentage of initial draw under existing authority
f. Mortgagee Letter published April 25, 2014
    i. Announced a Due and Payable deferral option for an eligible non-borrowing spouse upon the death of the last surviving mortgagor
g. Mortgagee Letter published June 18, 2014
    i. Limited FHA insurability of Fixed Interest rate products under the HECM Program to a single disbursement, one time draw at close. This policy followed Ginnie Mae's

policy announcement that for fixed-rate loans, it would only allow securitization of fixed-rate loans with a Single Lump Sum Draw at close

h. Mortgagee Letter published June 27, 2014
    i. Implemented new Principal Limit Factors (PLFs) which were effective August 4, 2014. PLF tables included PLFs for younger non-borrowing spouses that are eligible for the due and payable deferral period
    ii. Uses the authority granted HUD in the Reverse Mortgage Stabilization Act of 2013 to amend the FHA HECM program regulations and requirements concerning due and payable status where there is a Non-Borrowing Spouse at the time of loan closing
i. Mortgagee Letters published November 10, 2014
    i. Revised the HECM program's Financial Assessment and Property Charge Set Aside requirements
    ii. Announced a new Financial Assessment and Property Charge Guide
j. Mortgagee Letter published January 9, 2015
    i. Defined a new type of Non-Borrowing spouse (Ineligible), provided new model certification language, new model language for mortgages, notes, and loan agreements, provided a 30-day cure to reinstate a deferral period, and provided clarification and additional documentation for seasoning requirements
k. Mortgagee Letter published March 27, 2015
    i. Established a monthly growth rate for Life Expectancy Set-Asides
l. Mortgagee Letter published April 23, 2015
    i. Provided guidance on FHA's policies and timing requirements applicable to HECMs, including requirement for notice of "due and payable" status, and the requirement to provide notice of initiation of foreclosure
m. Mortgagee Letter published April 23, 2015
    i. Revised permissible loss mitigation options for when property charges are not paid in accordance with the terms of a HECM
n. Mortgagee Letter published June 12, 2015
    i. Provided an alternative option for claim payment for an eligible HECM with an Eligible Surviving Non-Borrowing Spouse

6. Increased enforcement for FHA-approved lenders

a. Enforcement actions taken against lenders
    i. Heightened enforcement of HUD requirements for FHA-approved lenders has yielded over:
        1. 1,940 lenders withdrawal from FHA's program as a result of violations of FHA approval, origination, or servicing requirements; and
        2. Imposition of more than $22.82 million dollars in civil money penalties and administrative payments for FHA-approved lenders
    ii. Issued notice to lending community that FHA will pursue directly or through Federal partners those who falsely advertise lax eligibility requirements for FHA-insured mortgages
b. Mortgagee Letter effective January 21, 2010
    i. Enhanced monitoring of lender performance and compliance with FHA guidelines and standards

    ii. Expanded the Credit Watch Termination Initiative to include evaluation of lender underwriting performance in addition to origination performance
  c. Implementation of statutory authority to enforce indemnification provisions for lender's using the Lender Insurance process
    i. Final rule published January 25, 2012, with an effective date of February 24, 2012
    ii. Mortgagee Letter and Lender Insurance guide issued to implement this rule
  d. Final Rule and Mortgagee Letter effective May 20, 2013
    i. Increased minimum net worth requirement for FHA-approved lenders to $1 million plus 1% of the lender's FHA mortgage volume in excess of $25 million
    ii. Required that lenders hold 20% of minimum required net worth in liquid assets
  e. Mortgagee Letter effective December 31, 2013
    i. Announce the implementation of FHA's Tier Ranking System II (TRS II)
    ii. TRS II will be used to evaluate a mortgagee's compliance with FHA's Loss Mitigation guidance, default servicing regulations, and default reporting requirements

7. **Changes to FHA lender approval requirements**
  a. Mortgagee Letter effective January 1, 2010
    i. Submission of audited financial statements required for supervised lenders
  b. Final rule published week of April 20, 2010
    i. Increased net worth requirements for approved mortgagees. All new lender applicants for FHA programs must possess a minimum net worth of $1 million. Effective one year from enactment of the rule, current FHA approved lenders, with the exception of small businesses, must possess a minimum net worth of $1 million. Current FHA-approved small business lenders must possess a minimum net worth of $500,000. Effective three years after enactment of the rule, approved lenders and applicants to FHA single family programs, regardless of size, must have a net worth of $1 million plus 1% of total loan volume in excess of $25 million
    ii. Eliminated independent FHA approval of mortgage brokers who originate but do not underwrite loans. FHA-approved mortgagees which underwrite loans retain strict liability for all loans, regardless of origination via their retail operations or through their sponsored mortgage brokers
    iii. Codified requirements for submission of audited financial statements by supervised mortgagees
  c. Mortgagee Letter published on January 5, 2011
    i. Required mortgagees that possess National Mortgage Licensing System & Registry (NMLS) IDs to provide those to FHA for both lender approval and loan origination processes
  d. Mortgagee Letter effective July 28, 2011
    i. Provided alternative financial reporting requirements for small supervised lenders to decrease burdens associated with FHA's lender approval and renewal processes
  e. Mortgagee Letter effective September 23, 2011
    i. Announced changes to requirements for obtaining, maintaining, and utilizing FHA approval, including:
      1. Defined corporate officers and principal owners
      2. Clarified requirements around office facilities and conversion of FHA lender type
      3. Prohibited net branching arrangements

    4. Expanded the single family origination lending area of each home office and registered branch office to include all HUD field office jurisdictions
    5. Required lenders to notify FHA within 10 days of any business changes, including changes in corporate officers or owners
    6. Required lenders to register all "Doing Business As" names with FHA

f. Mortgagee Letter effective December 11, 2012
   i. Informed lenders of changes to the way in which HUD calculates recertification fees

g. Mortgagee Letter effective December 21, 2012
   i. Provided alternative financial reporting requirements for small supervised lenders to decrease burdens associated with FHA's lender approval and renewal processes (follow up to July 28, 2011 Mortgagee Letter)

h. Final rule published September 17, 2013
   i. Effective October 17, 2013
   ii. Permanently waived the requirement for small supervised lenders with less than $500 million in consolidated assets to submit audited financial statements as a condition of FHA approval or renewal

i. Mortgagee Letter published September 27, 2013 effective March 31, 2014
   i. Announced the consolidation of Title I and Title II lender identification numbers

8. Updated Quality Control Requirements for Direct Endorsement Lenders

a. Mortgagee Letter effective January 5, 2011
   i. Updated FHA's quality control requirements to include new requirements related to Sponsored Third Party Originators, reporting of fraud and material deficiencies, and recording of sales or transfers of FHA mortgages

b. Mortgagee Letter effective April 15, 2011
   i. Communicated requirements regarding the use of official HUD/FHA logos, seals, names, and acronyms used by lenders in advertising devices

c. Mortgagee Letter effective September 6, 2011
   i. Announced that FHA-approved holders and servicers are subject to sanctions for failure to report Mortgage Record Changes for mortgage sales, transfers, and terminations of mortgage insurance

d. Mortgagee Letter effective November 13, 2013
   i. Clarified lender self-reporting requirements when in the course of required quality control activities lenders discover loans that violate FHA requirements

9. Refinance Program Policy

a. Mortgagee Letter published February 14, 2011
   i. Extensive guidance regarding requirements and changes for FHA Standard and Streamlined refinance programs

b. Mortgagee Letter published March 6, 2012
   i. For borrowers who are current on their loans, FHA reduced the upfront and annual MIPs for Streamline refinances of FHA-insured loans endorsed on or before May 31, 2009 to permit these borrowers to take advantage of historically low interest rates, reducing their payments and decreasing risk to FHA

10. Consolidated and updated FHA condominium policy

a. Mortgagee Letter issued June 30, 2011, and effective August 29, 2011
    i. Consolidated guidelines published in 2009
    ii. Provided a single source of information for the Condominium Approval and Recertification Process
    iii. Updated, consolidated and clarified existing condominium policy guidance
    iv. Expanded FHA's flexibility to consider exceptions at the individual project level
b. Mortgagee Letter issued in summer 2012 to revise updated guidance
c. Mortgagee Letter published August 29, 2014
    i. Announced an extension of the temporary condominium project approval guidelines to allow time for completion of the condominium rulemaking process
    ii. Relief was provided in the condominium approval process requirements to address the current housing market conditions.

11. Loss Mitigation

a. Mortgagee Letter effective February 14, 2013
    i. Revised the requirements for FHA's Loss Mitigation Home Retention Options, in an effort to reduce the number of full claims against the FHA Mutual Mortgage Insurance Fund by assisting a greater number of qualified, distressed mortgagors in retaining their homes
b. Mortgagee Letter effective July 1, 2013
    i. Issued guidance on subordinating partial claims for FHA Streamlined refinances
c. Mortgagee Letter effective July 1, 2013
    i. Issued guidance on the interest rates for loss mitigation home retention homes
d. Mortgagee Letter effective September 1, 2013
    i. Updated clarification regarding title approval at conveyance
e. Mortgagee Letter effective August 1, 2013
    i. Issued guidance on partial claim documentation and delivery requirements
f. Mortgagee Letter effective June 27, 2013 or October 1, 2013
    i. Extended unemployment special forbearance
g. Mortgagee Letter effective October 1, 2013
    i. Confirmed priority for mortgagor in default. Mortgagee must evaluate viability of a pre-foreclosure sale before a Deed-in-Lieu. Updated pre-foreclosure and Deed-in-Lieu of Foreclosure requirements including documentation requirements to verify assets, income and expenses; use of a Deficit Income Test; elimination of financial hardship requirement for service members with PCS's and validation requirements for appraisals. Requires arm's length transaction
h. Mortgagee Letter effective January 1, 2014
    i. Clarifies methods of communications with borrowers and addresses importance of early contact early in the delinquency. In addition to requiring standardized escalation procedures
i. Mortgagee Letter effective January 1, 2014
    i. Clarifies loss mitigation requirements before foreclosure can be initiated and communication requirements during the foreclosure process
j. Mortgagee Letter effective October 1, 2014
    i. Sets forth the Department's policies on Pre-Foreclosure Sales and Deed in Lieu transactions

k. Mortgagee Letter effective October 1, 2014
    i. Provides guidance on the retention of foreclosure-related documents in servicing files (stored electronically) and to extend the record retention period to at least seven years after the life of an FHA-insured mortgage
l. Mortgagee Letter effective June 1, 2015
    i. Communicated FHA's requirements for a Trial Payment Plan (i.e., associated with any FHA loan modification) as related to the plan's duration, required signatures, and conditions under which FHA deems a plan to have failed
m. Mortgagee Letter effective September 1, 2015
    i. Revised timeframes for mortgagees to submit promissory notes associated with partial claims
n. Mortgagee Letter effective September 14, 2015
    i. Adjusted definitions for HUD REO purchasing
o. Mortgagee Letter effective October 1, 2015
    i. Reiterated the existing eight automatic extensions for mortgage servicers to file first legal action on FHA defaulted mortgage loans and to add two new automatic extensions, which are associated with mortgage servicers' compliance with the Consumer Financial Protection Bureau
p. Mortgagee Letter effective November 1, 2015
    i. Provided a revised Sample Notice to Occupants of Pending Acquisition, which advises occupants of the criteria upon which they may be able to remain in a property for an extended period of time post-foreclosure
q. Mortgagee Letter effective January 1, 2016
    i. Updated the reasonable due diligence timeframes for conveyance of single family properties insured by FHA and to update foreclosure Attorney Fee Schedule

12. Housing Counseling

a. Published a Proposed Rule regarding new certification requirements for housing counselors
    i. Continued to review comments, conduct outreach and training, design a housing counselor certification examination, and build a platform to create a certification roster
    ii. Launched a website June 4, 2015, www.hudhousingcounselors.com, to provide free training in preparation for the examination
b. Home Owners Armed With Knowledge (HAWK)
    i. During 2014, a proposed pilot was published for HAWK for New Homebuyers. It was halted by Congress in December 2014 and HUD completed an orderly shut-down of the planning in January 2015.
c. Continued to incorporate housing counseling into FHA lending
    i. Mortgagee Letter effective August 15, 2013 through September 30, 2016: Extenuating Circumstances/Back to Work
    ii. Published Mortgagee Letter 15-04 providing clearer notice to delinquent FHA borrowers of the benefits and availability of HUD housing counseling agencies to assist them
d. HECM changes
    i. In concert with changes made by FHA to the reverse mortgage program to reduce risk for borrowers, HUD's Office of Housing Counseling trained reverse mortgage

counselors on the changes and reminded them about their responsibilities to provide unbiased and detailed reviews of the features of reverse mortgage products

ii. Published HECM Housing Notice 14-17, Guidance to Housing Counselors for HECM Non-Borrowing Spouses and Heirs

e. Housing Counseling Federal Advisory Committee

i. Established the Committee April 14, 2015 through notice filed with Library of Congress, Congress, and Federal Register Notice

ii. Requested applications in April 2015

13. Guidance on Nonprofits Assisting Government Entities in Providing Secondary Financing in Conjunction with FHA-Insured Mortgages

a. Mortgagee Letter effective June 29, 2014

i. Clarified circumstances under which a nonprofit assisting a government entity with a secondary financing program needs to be approved by HUD and placed on its Nonprofit Roster

1. Nonprofits do not need to be HUD-approved if the functions they are performing are limited to the government entities secondary financing program and the note and deed of trust name the government entity as the Mortgagee

2. Nonprofits do need to be placed on our Roster where the secondary financing will be closed in their name

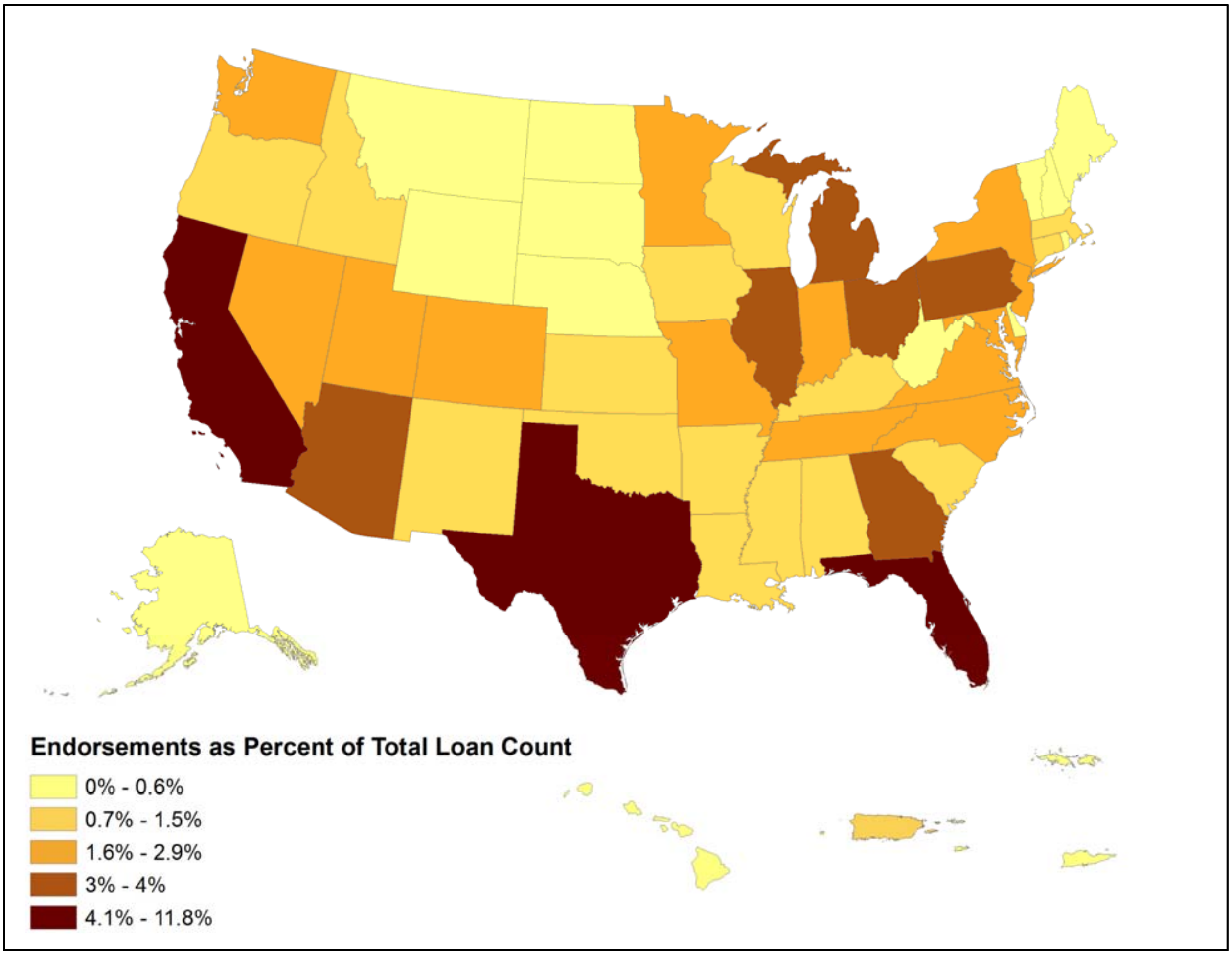
Appendix B: Additional Data Tables

Exhibit B-1
FHA Single Family Mortgage Insurance Endorsements

	Counts by Loan Purpose					
Fiscal Year	Home Purchase	FHA Streamline Refinance	Other FHA Refinance	Conventional-to-FHA Refinance	All Forward Loans	Volume ($ billions)
2000	839,870	34,443	6,780	32,007	913,100	94.2
2001	806,818	188,422	17,230	46,207	1,058,677	117.7
2002	862,898	318,245	28,525	64,475	1,274,143	148.1
2003	658,640	560,891	37,504	62,694	1,319,729	159.2
2004	586,110	291,483	26,147	56,695	960,435	116.0
2005	353,844	113,062	11,840	33,581	512,327	62.4
2006	313,998	36,374	14,722	60,397	425,491	55.3
2007	278,395	22,087	16,504	107,739	424,725	59.8
2008	631,655	66,772	28,510	360,456	1,087,393	181.2
2009	995,550	329,437	38,071	468,941	1,831,999	330.5
2010	1,109,580	212,896	39,598	305,534	1,667,608	297.6
2011	777,428	180,265	44,559	195,559	1,197,811	217.8
2012	733,863	274,061	47,595	129,221	1,184,740	213.3
2013	702,415	511,843	39,084	91,505	1,344,847	240.1
2014	594,999	115,040	20,963	55,353	786,355	135.2
2015	753,389	232,813	50,002	80,028	1,116,232	213.1
2012 Q1	176,168	36,657	11,231	31,851	255,907	44.6
2012 Q2	166,168	62,179	13,376	36,615	278,338	50.0
2012 Q3	193,557	70,389	14,037	38,077	316,060	57.8
2012 Q4	197,970	104,836	8,951	22,678	334,435	60.9
2013 Q1	177,852	142,365	10,155	22,756	353,128	63.7
2013 Q2	157,439	156,019	11,467	25,429	350,354	63.7
2013 Q3	181,297	140,372	10,534	24,177	356,380	63.3
2013 Q4	185,827	73,087	6,928	19,143	284,985	49.4
2014 Q1	152,965	35,909	5,003	14,610	208,487	35.8
2014 Q2	119,833	26,406	4,797	13,456	164,492	28.3
2014 Q3	148,017	26,881	5,161	13,574	193,633	32.8
2014 Q4	174,184	25,844	6,002	13,713	219,743	38.3
2015 Q1	154,807	23,530	7,435	15,827	201,599	35.2
2015 Q2	132,529	43,004	9,175	15,431	200,139	37.2
2015 Q3	198,801	97,354	17,007	21,492	334,654	66.1
2015 Q4	267,252	68,925	16,385	27,278	379,840	74.7

NOTE: This table includes all single family endorsements. Prior to FY 2009, the 203(k) program (Mortgage Insurance for Home Rehabilitation) and 234(c) program (Mortgage Insurance for Condominium Units) were not obligations of the MMI Fund. They are included for all years in this table to provide a complete picture of FHA activity.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-2
FHA New Endorsement Activity by State, FY 2015



NOTE: See Exhibit B-3 for number of endorsements by state.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-3
FHA New Endorsement Activity by State, FY 2015

State/Territory	Endorsements	State/Territory	Endorsements
Alabama	15,601	Nebraska	6,389
Alaska	2,091	Nevada	19,955
Arizona	44,368	New Hampshire	4,791
Arkansas	8,200	New Jersey	29,605
California	131,726	New Mexico	7,305
Colorado	32,552	New York	31,205
Connecticut	11,005	North Carolina	26,721
Delaware	4,178	North Dakota	2,433
District of Columbia	1,121	Ohio	42,173
Florida	74,785	Oklahoma	12,639
Georgia	43,402	Oregon	13,942
Hawaii	957	Pennsylvania	37,919
Idaho	8,365	Puerto Rico	8,646
Illinois	38,680	Rhode Island	4,493
Indiana	29,432	South Carolina	16,304
Iowa	7,264	South Dakota	2,206
Kansas	9,512	Tennessee	25,387
Kentucky	13,663	Texas	94,957
Louisiana	13,323	Utah	20,743
Maine	2,707	Vermont	861
Maryland	29,709	Virgin Islands	37
Massachusetts	15,508	Virginia	31,731
Michigan	36,453	Washington	27,008
Minnesota	20,680	West Virginia	3,021
Mississippi	7,630	Wisconsin	13,288
Missouri	23,979	Wyoming	2,520
Montana	2,768		

SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-4
FHA Purchase Endorsements as a Proportion of Total State Purchase Originations, CY 2014

Rank	State/Territory	FHA Purchase Endorsement Loans	Total State Purchase Originations	Percent of State Purchase Originations
1	Nevada	22,073	63,985	34
2	Puerto Rico	7,848	23,703	33
3	Arizona	52,273	167,182	31
4	Indiana	34,934	122,866	28
5	Georgia	55,767	197,800	28
6	Rhode Island	4,427	15,847	28
7	Maryland	30,839	112,033	28
8	Ohio	50,653	187,205	27
9	Oklahoma	20,865	79,947	26
10	Utah	19,949	79,186	25
11	Michigan	42,731	169,846	25
12	Texas	154,073	613,814	25
13	New Mexico	8,279	33,413	25
14	New Jersey	31,880	133,229	24
15	Pennsylvania	44,693	187,694	24
16	Florida	96,056	410,955	23
17	Delaware	4,692	20,222	23
18	Illinois	50,274	217,762	23
19	California	127,101	552,016	23
20	Connecticut	11,860	52,841	22
21	Kansas	11,374	51,389	22
22	Missouri	25,302	117,559	22
23	New York	43,000	202,450	21
24	Tennessee	29,469	139,365	21
25	Alabama	18,429	87,260	21
26	Colorado	34,166	162,724	21
27	Nebraska	7,516	36,184	21
28	Idaho	7,589	37,313	20
29	Louisiana	18,547	91,202	20
30	Minnesota	23,512	116,866	20
31	Mississippi	8,711	43,509	20
32	Alaska	3,001	15,053	20
33	New Hampshire	5,059	25,845	20
34	Virginia	32,428	171,896	19
35	Kentucky	14,218	77,145	18
36	Arkansas	10,953	59,552	18
37	Washington	28,460	156,223	18
38	Wyoming	2,604	14,606	18
39	South Carolina	19,147	107,910	18
40	North Dakota	2,895	16,829	17
41	Oregon	14,622	85,274	17
42	North Carolina	31,573	206,091	15
43	Massachusetts	17,425	114,634	15
44	South Dakota	2,558	17,277	15
45	Montana	2,987	21,094	14
46	Wisconsin	12,628	91,323	14
47	Iowa	8,144	60,336	13
48	West Virginia	3,634	27,335	13
49	Maine	3,050	24,091	13
50	District of Columbia	1,458	13,259	11
51	Vermont	848	9,086	9
52	Hawaii	746	17,457	4
	U.S.A.	1,354,880	6,103,800	22

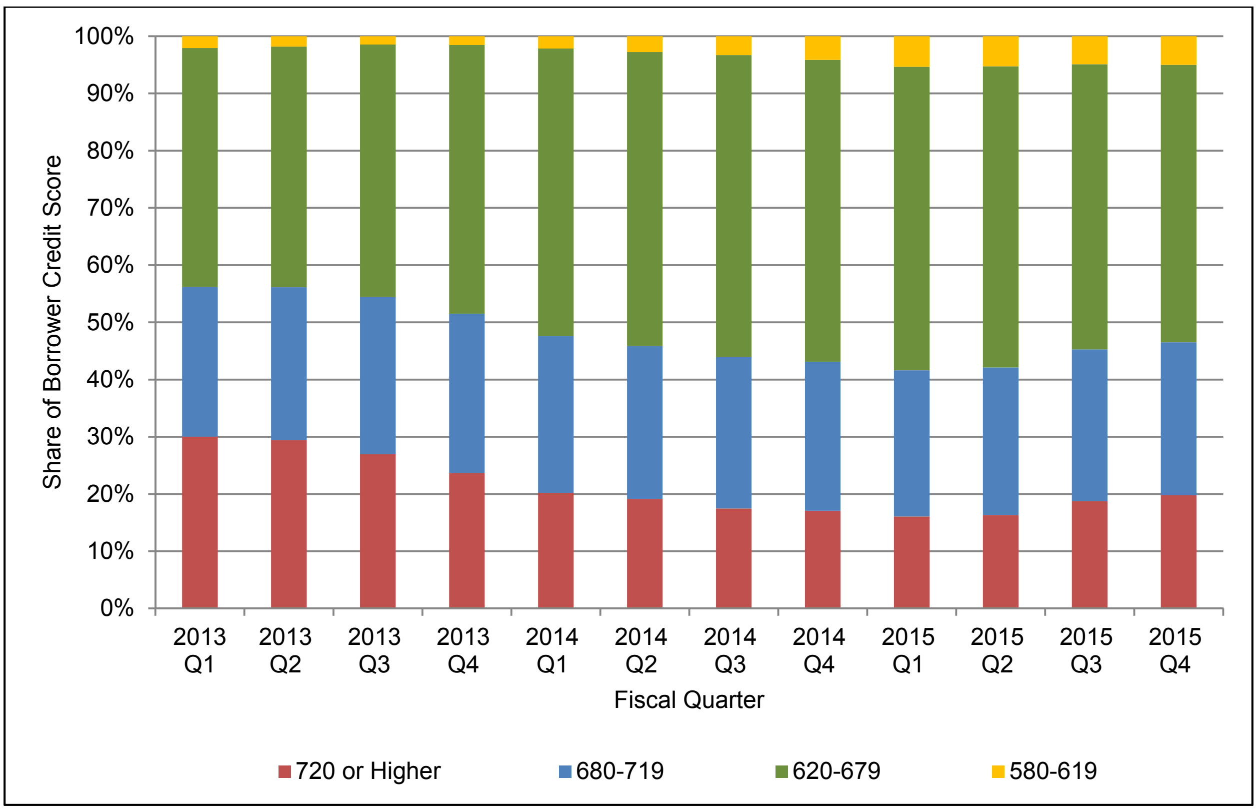
SOURCE: HMDA, 2014.

Exhibit B-5
FHA Loan Count and Average Loan Amount by Loan Purpose

FY 2015	Home Purchase		FHA Streamline Refinance		Other FHA Refinance		Conventional-to-FHA Refinance		All Forward Loans	
Oct	58,784	$178,722	8,499	$148,028	2,568	$183,037	5,773	$162,346	75,624	$174,169
Nov	44,835	177,650	6,751	148,724	2,143	182,553	4,570	165,745	58,299	173,548
Dec	51,188	178,273	8,280	161,156	2,724	189,791	5,484	165,780	67,676	175,630
Jan	49,925	180,794	8,256	164,054	2,654	190,257	5,452	168,287	66,287	178,059
Feb	37,036	179,752	7,215	169,014	1,935	188,014	4,225	167,368	50,411	177,494
Mar	45,568	181,964	27,533	222,839	4,586	214,361	5,754	179,658	83,441	197,073
Apr	57,909	182,982	32,809	222,927	5,879	220,227	6,807	186,868	103,404	198,029
May	60,944	185,781	29,875	221,751	5,295	218,860	6,687	184,454	102,801	197,851
Jun	79,948	188,504	34,670	213,922	5,833	214,682	7,998	188,587	128,449	196,558
Jul	90,217	191,967	29,102	209,500	5,858	210,031	9,018	188,664	134,195	196,336
Aug	90,481	195,303	21,423	210,489	5,407	209,135	9,009	191,736	126,320	198,216
Sep	86,554	193,085	18,400	208,622	5,120	199,662	9,251	186,740	119,325	195,271
Total	753,389	$186,176	232,813	$206,630	50,002	$206,378	80,028	$180,340	1,116,232	$190,928

SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-6
Distribution of FHA Borrower Credit Scores for FY 2013–FY 2015



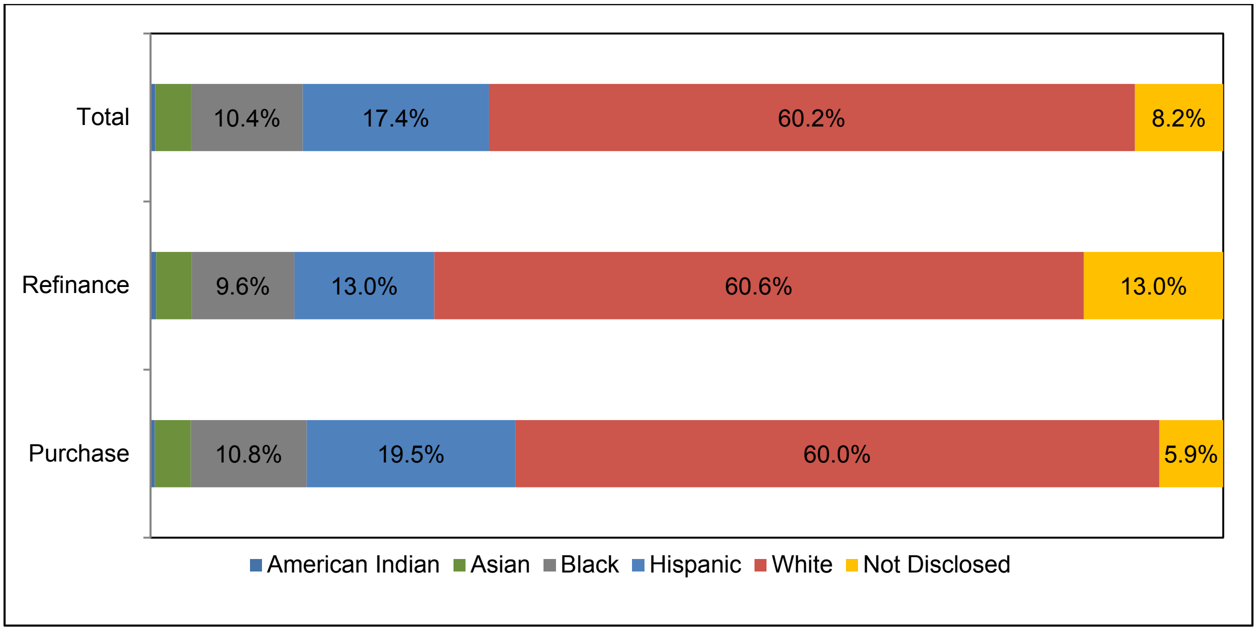
NOTE: Data exclude streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-7
Distribution of FHA Borrower Credit Scores by Fiscal Year and Quarter

Fiscal Year	Quarter	720 or Higher	680–719	620–679	580–619	579 or Lower	Missing
2008	Oct–Dec	8.9	8.9	31.0	24.1	23.4	3.8
	Jan–Mar	9.5	9.7	31.7	23.4	22.4	3.3
	Apr–Jun	14.7	13.0	35.7	21.1	13.1	2.4
	Jul–Sep	18.5	15.8	37.7	19.3	7.1	1.6
2009	Oct–Dec	20.5	17.2	37.5	18.6	5.2	1.0
	Jan–Mar	24.3	18.9	36.9	15.5	3.4	1.1
	Apr–Jun	29.6	21.2	38.1	8.4	1.5	1.1
	Jul–Sep	33.3	22.1	37.7	4.9	1.0	1.0
2010	Oct–Dec	33.5	22.5	38.5	4.0	0.7	1.0
	Jan–Mar	33.9	22.8	38.4	3.5	0.5	1.0
	Apr–Jun	34.9	22.6	38.4	2.7	0.4	1.0
	Jul–Sep	34.8	22.6	38.3	3.0	0.4	0.9
2011	Oct–Dec	37.0	23.2	36.0	2.5	0.3	0.9
	Jan–Mar	37.7	24.1	35.0	2.2	0.2	0.8
	Apr–Jun	35.3	23.8	37.5	2.6	0.2	0.7
	Jul–Sep	33.1	23.8	39.2	3.3	0.2	0.6
2012	Oct–Dec	32.9	23.9	39.3	3.2	0.2	0.5
	Jan–Mar	33.9	23.9	38.8	2.8	0.2	0.4
	Apr–Jun	33.2	24.2	39.5	2.5	0.2	0.4
	Jul–Sep	30.9	25.3	41.1	2.3	0.2	0.4
2013	Oct–Dec	29.9	26.0	41.6	2.1	0.2	0.3
	Jan–Mar	29.2	26.6	41.9	1.8	0.2	0.3
	Apr–Jun	26.9	27.4	43.9	1.5	0.1	0.3
	Jul–Sep	23.6	27.7	46.7	1.6	0.2	0.2
2014	Oct–Dec	20.1	27.3	50.1	2.2	0.1	0.2
	Jan–Mar	19.1	26.6	51.1	2.8	0.2	0.2
	Apr–Jun	17.4	26.4	52.5	3.3	0.2	0.2
	Jul–Sep	17.0	26.0	52.5	4.1	0.2	0.2
2015	Oct–Dec	16.0	25.4	52.8	5.3	0.3	0.2
	Jan–Mar	16.3	25.7	52.4	5.2	0.3	0.2
	Apr–Jun	18.7	26.5	49.7	4.9	0.2	0.2
	Jul–Sep	19.7	26.6	48.3	5.0	0.2	0.2

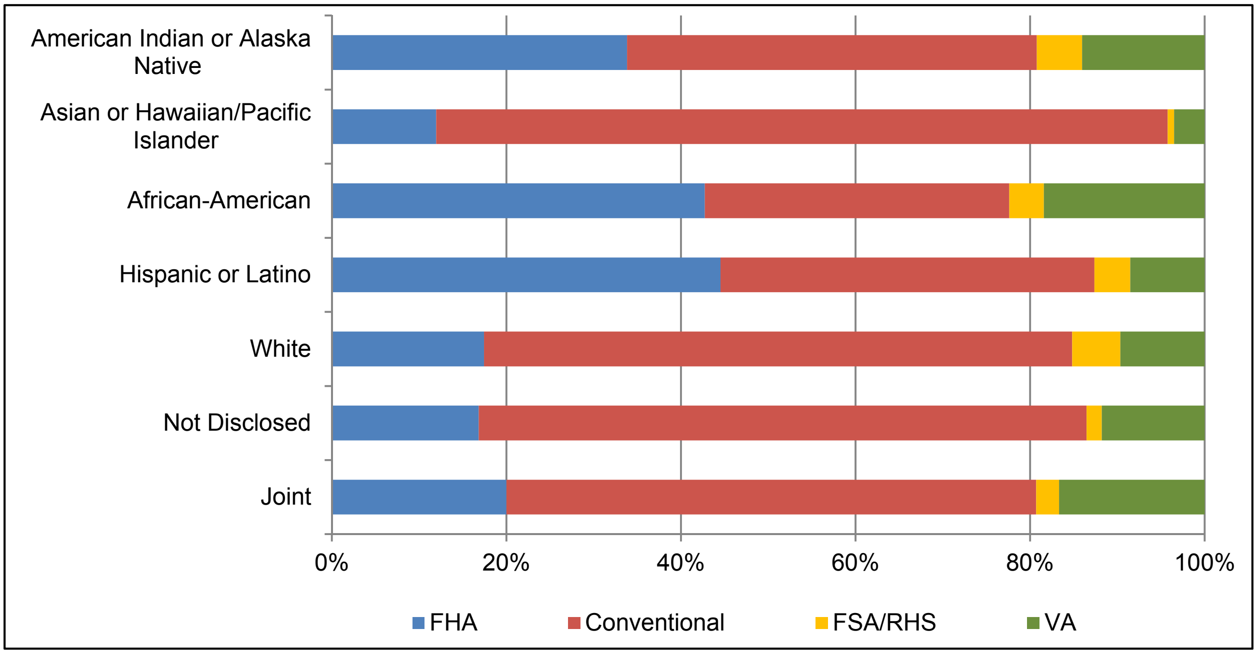
NOTE: Shares are based on loan counts. Data exclude streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-8
Racial Composition for FHA Single Family Endorsements, FY 2015



SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-9
Home Purchase Loans and Racial Shares across Market Segments, CY 2014



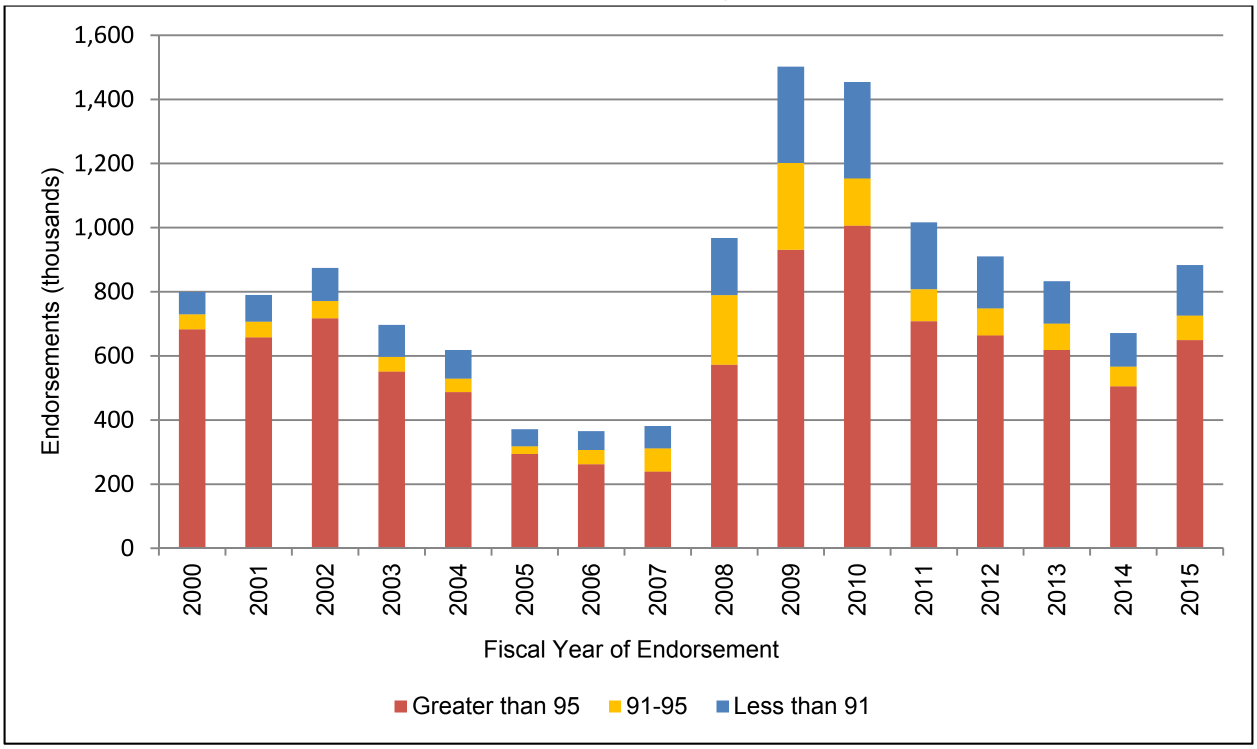
NOTE: See Exhibit B-10 for notes and data.
SOURCE: FFIEC/HMDA Data, 2014.

Exhibit B-10
Home Purchase Loans and Racial Shares across Market Segments, CY 2014

Race or Ethnicity	Number of Loans	Conventional	FHA	FSA/RHS	VA
All Borrowers	2,856,351	64.4	20.9	10.1	4.7
American Indian or Alaska Native	10,433	46.9	33.8	14.1	5.2
Asian or Hawaiian/Pacific Islander	158,503	83.8	11.9	3.5	0.7
Black or African-American	148,146	34.9	42.7	18.4	4.0
Hispanic or Latino	247,743	42.8	44.5	8.5	4.1
White	1,994,852	67.4	17.4	9.7	5.5
Not Disclosed[a]	208,481	69.6	16.8	11.8	1.7
Joint[b]	88,193	60.7	20.0	16.7	2.6

FSA = Farm Service Agency, RHS = Rural Housing Service, VA = Veterans Administration.
[a] Includes Missing and Not Applicable.
[b] Applies when one applicant reports a single racial designation of White and the other applicant reports one or more minority racial designations.
NOTE: Race on the loan application is categorized by the first person listed on the loan application. The Home Mortgage Disclosure Act reports race separately from ethnicity.
SOURCE: FFIEC/HMDA Data, 2014.

Exhibit B-11
Distribution of FHA Endorsements by Loan-to-Value Ratio



NOTE: Excludes streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-12
Distribution of FHA Endorsements by Loan-to-Value Ratio

Fiscal Year of Endorsement	Loan-to-Value Categories			
	Less Than 91	91-95	Greater Than 95	Total
2000	70,030	46,930	682,743	799,703
2001	83,276	48,718	657,894	789,888
2002	103,411	54,117	717,009	874,537
2003	99,695	45,913	551,112	696,720
2004	89,316	41,899	487,085	618,300
2005	53,368	23,684	294,349	371,401
2006	58,643	44,633	262,044	365,320
2007	69,736	72,557	239,165	381,458
2008	178,030	217,475	572,344	967,849
2009	300,026	271,250	930,647	1,501,923
2010	300,865	146,993	1,006,176	1,454,034
2011	208,347	99,782	708,317	1,016,446
2012	162,121	84,487	663,855	910,463
2013	132,000	82,302	618,697	832,999
2014	104,618	61,307	505,389	671,314
2015	157,251	76,715	649,207	883,173

NOTE: Excludes streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-13
FHA Foreclosure Starts

SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-14
FHA Foreclosure Starts

Month	Foreclosure Starts	Month	Foreclosure Starts	Month	Foreclosure Starts
10/10	19,388	06/12	27,322	02/14	12,835
11/10	15,937	07/12	25,709	03/14	13,774
12/10	14,871	08/12	25,426	04/14	13,032
01/11	14,490	09/12	20,677	05/14	11,040
02/11	13,925	10/12	23,690	06/14	11,037
03/11	14,739	11/12	18,305	07/14	11,050
04/11	11,699	12/12	17,778	08/14	10,615
05/11	10,754	01/13	17,843	09/14	11,438
06/11	11,209	02/13	16,662	10/14	12,315
07/11	10,511	03/13	16,788	11/14	9,925
08/11	12,257	04/13	19,471	12/14	11,636
09/11	12,176	05/13	17,765	01/15	13,177
10/11	12,156	06/13	16,352	02/15	12,732
11/11	14,255	07/13	15,550	03/15	13,625
12/11	14,066	08/13	15,476	04/15	12,406
01/12	16,062	09/13	14,958	05/15	10,167
02/12	18,724	10/13	15,702	06/15	10,897
03/12	21,741	11/13	13,285	07/15	10,560
04/12	22,059	12/13	13,808	08/15	11,156
05/12	30,158	01/14	13,663	09/15	11,544

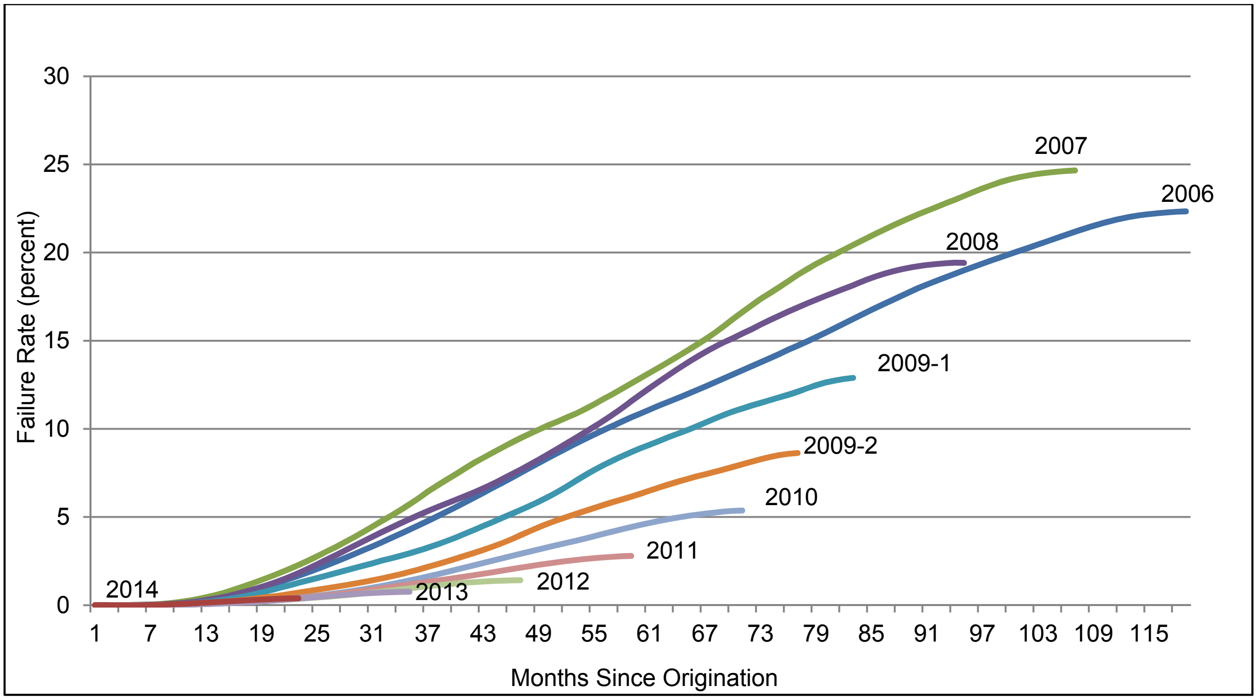
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-15
Serious Delinquency Rates by Loan Origination Year at Various Stages of Seasoning

Age (years)	Fiscal Year of Origination (%)									
	2014	2013	2012	2011	2010	2009-2	2009-1	2008	2007	2006
1	1.4	0.9	1.0	1.2	1.2	1.6	5.4	7.0	5.7	3.5
2		2.3	2.6	3.2	4.0	4.1	10.5	17.0	14.5	7.7
3			3.2	4.2	5.9	7.2	14.7	19.7	21.5	13.0
4				4.5	6.3	8.6	19.3	24.5	22.5	17.2
5					6.0	8.0	18.5	26.1	26.2	17.6
6							17.0	23.5	26.0	20.1
7								20.8	23.7	20.5
8									21.0	19.3
9										17.1

NOTE: Excludes streamline refinances.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-16
Failure Rates by Seasoning and Vintage



NOTES: A failure rate is the sum of to-date claims and active foreclosures, as a percentage of initial endorsements for each vintage. Excludes streamline refinances. The 2009 vintage is separated into two parts, representing loan originations from October through March in 2009-1 and loan originations from April through September in 2009-2.
SOURCE: U.S. Department of HUD/FHA, October 2015.

Exhibit B-17
Number of Assisted Cures by Fiscal Year with Assistance Type

Fiscal Year of Assisted Cure	Repayment Plans	Loan Modifications	Partial Claims	FHA HAMP	Promise to Pay	Total Assisted Cures
	Type of Loss Mitigation Assistance					
	Assistance Counts					
2007	123,771	44,021	7,951			175,743
2008	164,831	59,424	5,271			229,526
2009	110,769	72,768	8,894			192,431
2010	132,087	154,060	11,348	2,298		299,793
2011	216,387	146,213	12,188	9,366		384,154
2012	254,774	82,735	6,861	14,966		359,336
2013	293,699	97,740	14,669	59,962	1,344	467,414
2014	171,076	12,664	29,604	141,992	125,100	480,436
2015	124,557	7,010	69,880	74,908	167,033	443,388
	Shares by Assistance Type within Fiscal Year (%)					
2007	70.4	25.0	4.5	0.0	0.0	100.0
2008	71.8	25.9	2.3	0.0	0.0	100.0
2009	57.6	37.8	4.6	0.0	0.0	100.0
2010	44.1	51.4	3.8	0.8	0.0	100.0
2011	56.3	38.1	3.2	2.4	0.0	100.0
2012	70.9	23.0	1.9	4.2	0.0	100.0
2013	62.8	20.9	3.1	12.8	0.3	100.0
2014	35.6	2.6	6.2	29.6	26.0	100.0
2015	28.1	1.6	15.8	16.9	37.7	100.0

HAMP = Home Affordable Modification Program.
SOURCE: U. S. Department of HUD/FHA, data as of October 14, 2015.

Exhibit B-18
Comparison of FY 2014 and FY 2015 Default Dispositions

	FY 2015			FY 2014		
Disposition Type	Loss Rate (% UPB)	Case Count	Share of Dispositions	Loss Rate (% UPB)	Case Count	Share of Dispositions
REO	56.10	51,954	50.27	60.11	71,351	45.09
Note Sales (DASP)	48.64	19,543	18.91	49.13	39,815	25.16
Third Party Sales	46.73	18,251	17.66	50.03	23,196	14.66
Pre-foreclosure Sales	40.00	13,609	13.17	44.34	23,869	15.08
Total	50.10	103,357	100.00	52.45	158,231	100.00

UPB = Unpaid Principal Balance, REO = real estate owned, DASP = Distressed Asset Stabilization Program.
SOURCE: U. S. Department of HUD/FHA; data as of October 14, 2015.

Appendix C: Definitions and Clarifications

1. Structure and Operation of the Mutual Mortgage Insurance Fund

Transactions associated with FHA's guarantee programs for single family mortgages are recorded in a series of federal government accounts known as the Mutual Mortgage Insurance Fund (MMIF or the Fund). The assets and liabilities of the MMIF are recorded in its financing accounts and capital reserve accounts.

Transactions arising from the MMIF's ongoing insurance operations are recorded in the financing accounts of the Forward and HECM programs. The capital reserve account is the ultimate repository for all net budgetary resources collected by the MMIF. Estimated net receipts from each book of insurance business are transferred from the financing accounts to the capital reserve account as each new guaranteed loan is disbursed. Expected net receipts are then re-estimated annually thereafter as part of the federal budget process. Re-estimates reflecting increased expected net federal receipts result in additional transfers from the financing accounts to the capital account. Re-estimates reflecting decreased expected net receipts result in transfers from the capital account to the financing accounts to ensure that each financing account has enough assets to meet all of its insurance obligations. Transfers from the capital reserve account to the financing account that would reduce the balance of the capital account below zero trigger mandatory appropriations sufficient to eliminate the deficit and ensure that the MMIF always has sufficient funds to meet its claim and other obligations.

For purposes of the actuarial studies, the net assets of the MMIF financing accounts are added to the balance of the capital reserve account as of each September 30 to calculate the current capital resources of the MMIF. The actuarial studies then combine the current capital resources of the MMIF with the estimated net receipts expected from future insurance transactions to estimate the economic value of the Fund.

2. Assessment of the Independent Actuary

The National Housing Act requires that HUD contract for an independent actuarial study of the MMIF each year.[6] The two portfolios of the Fund—forward (single family) and reverse (HECM) mortgages—are fundamentally different in characteristics and performance, so they are analyzed in two separate reports. The final written reports are available online in the FHA Office of Housing Reading Room.[7]

The actuarial studies use statistical models to develop long-term projections of default, claim, loss-on-claim, and prepayment rates on current and future books of business. The models are estimated using historical patterns of FHA-insured loan performance under a wide variety of economic conditions. They are applied to active loans, and they use commercially-available forecasts of

[6] See 12 USC 1708(a)(4).

[7] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgrroom.

home prices and interest rates to predict loan performance in the future. The resulting projections determine business-operation cash flows needed to estimate the economic value of the Fund.

The actuarial study applies a stochastic method to estimate the net present value (NPV) of future cash flows. This year, like last year, 100 equally likely paths were generated to develop a wide variety of possible economic conditions, creating what is known as a Monte Carlo simulation. The discounted NPV of cash flows was computed for each path. Then they were averaged to obtain an overall estimate of the expected NPV that provides the base-case estimate.

The outcome of the complete actuarial study modeling effort is the estimated economic net worth (ENW) of the MMIF, which is defined by the National Housing Act as capital resources plus the present value of future cash flows of the Fund.[8] The calculation of ENW is repeated for each of the next seven years by adding projected endorsements each year, forecasting their cash flows, and adding them to those of the current portfolio, and then reassessing ENW on the updated portfolio at the end of each fiscal year.

ENW represents additional resources directly available to FHA for absorbing claim expenses above-and-beyond those already anticipated in the present-value-of-future-cash-flow calculations. Those calculations are for the remaining life of all outstanding loan guarantees and can extend for more than 30 years on HECM loans. The statutory capital ratio is ENW divided by the outstanding dollar volume of active insurance contracts.

[8] See 12 USC 1711(f)(4). The statute refers only to capital resources (liquid assets) and the present value of future cash flows. The actuarial studies, however, include value of properties in inventory and net accounts receivable and payable in their calculation of capital resources rather than in the present value of future cash flows. This is because they do not predict these items, but rather take their values from the values used by FHA in its annual financial statements.