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A Message from Jeffrey Chalmers:

"FHA Financing may soon compete with Conventional."

Could FHA's Recovery Lead to Reduced Mortgage Insurance Premiums?

The Federal Housing Finance Agency (FHA) had to be bailed out by the U.S. Treasury during the financial crisis after its Mutual Mortgage Insurance Fund was nearly depleted. Congress has long mandated a 2.0 percent ratio in its fund, but the agency's 2011 annual report reported the fund was down to 0.24 percent of its balance of guaranteed loans. In its annual report this November FHA reported the FY2019 capital ratio of the fund was 4.85 percent.

This is a notable recovery, but even more so when compared to the ratio in FY2018, 2.76 percent. Both the forward portfolio with insurance on $1.2 trillion of mortgages and the reverse mortgage portfolio with insurance on $64 billion showed large improvements

Urban Institute (UI) analysts Laurie Goodman and Edward Goldman took a deeper look at **what was behind this dramatic increase** in a recent blog post in UI's *Urban Wire.*

The MMI fund's net worth for the forward portfolio increased from $46.8 billion to $66.6 billion in one year, giving it a capital ratio of 5.44 percent compared to 3.93 percent in 2018, a 1.51-point increase. These gains far outstripped those in recent years; the fund had a ratio of 3.33 in 2017 and 3.11 percent in 2016.

The UI analysts say this dramatic $19.8 billion one-year gain in FY2019 was **driven by two factors**: a $10.2 billion reduction in the estimate of the net present value (NPV) of future losses, and a $9.2 billion improvement in capital resources. They say they believe the agency's improved handling of defaulted properties has driven the change.

The $10.2 billion reduction in future losses is expected because of greater use of foreclosure alternatives and less reliance on recoveries via sale of real estate owned (REO). There have been fewer losses on insured loans lately and FHA is projecting fewer losses in the future. Insurance claims fell to around 67,400 properties in 2019 with a loss given default (LGD) rate of about 41 percent. In other words, 59 percent of loan balances was recovered. In

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.86%	-0.05	0.00
15 Yr. Fixed	6.31%	-0.02	0.00
30 Yr. FHA	6.32%	-0.06	0.00
30 Yr. Jumbo	7.04%	-0.03	0.00
5/1 ARM	6.53%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	6.78%	-0.08	0.00
15 Yr. Fixed	6.07%	-0.09	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.00%	-0.03	0.60
15 Yr. Fixed	6.63%	+0.07	0.61
30 Yr. FHA	6.87%	-0.03	0.92
30 Yr. Jumbo	7.13%	+0.02	0.38
5/1 ARM	6.22%	-0.16	0.60

Rates as of: 7/26

Recent Housing Data

		Value	Change
Mortgage Apps	Jul 10	206.1	-0.19%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

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contrast, from 2009 to 2018, the LGD fell below 50 percent only once and was often over 60 percent.

		Value	Change
Builder Confidence	Mar	51	+6.25%

Losses are down because **FHA is making greater use of foreclosure alternatives such as short sales and claims without conveyance of title.** There have also been improvements to losses when the REO channel is required.

The authors say FHA has not explained why it expects a $10.2 billion improvement in the NPV of future losses, but they assume this reflects the agency's belief that the lower LGD will continue in future years. It decreased from approximately $43.9 billion to $33.8 billion, or approximately 25 percent, which would indicate that the LGD was not reduced by the full amount reflected in recent performance. There are other explanations for the lower NPV such as improving loan quality or a higher forecast for house price gains going forward. Neither would seem to be the case as home price appreciation has been slowing and the 2019 vintage of loans had worse credit characteristics than other recent years.

The second factor, the **$9.2 billion increase in capital resources, is primarily the result of profitable new business.** FHA revenue is based on the 85-basis point mortgage insurance premium on the $1.2 trillion in insurance in force (about $10 billion annually) and the upfront premium of 175 basis points on the $215 billion in new insurance written during the year. The later provides revenue of about $4 billion. Out of this was paid claims of approximately $4 billion.

Goodman and Golding say the gap between revenue and claims is not surprising, given the good credit mix in the years following the Great Recession, the near doubling of the mortgage insurance premium (MIP), and the strong house price appreciation of the past seven years. Even the 2019 book of business was profitable despite its declining credit quality.

They say it is **likely the improvements in the forward fund ratio will continue** because a structural shift, such as changing the methods of disposition is one that usually persists. The shortage of available homes, especially at the lower end of the market where FHA is most active, is pushing up home prices which reduces delinquencies and improves loan recoveries. However, and FHA's annual report also addresses how high the ratio should be. It suggests an appropriate target would be 8.0 percent after adding back the NPV of future losses. The current ratio under that calculation is 8.2 percent. However, if the reverse mortgage portfolio is added in, the MMI is short of its target. The authors restate an earlier contention that the home equity conversion (HECM) program should not be included with forward mortgages in the fund.

The rate of accumulation of capital reserves each year is about 75 basis points in today's economy and the UI analysis suggests that the **FHA might consider reducing the mortgage insurance premiums.** They say a straight cut to the premium would have a greater effect on improving housing affordability than another suggestion, allowing homeowners to eliminate the premium when their loan-to-value ratio reaches 78 percent. This typically occurs 9 to 10 years after origination at today's interest rates.

They conclude that the improved financial health of the FHA is encouraging, and the annual report suggests that this improvement will continue. This gives the FHA the ability to cut the MIP if it chooses to. They also suggest FHA should supplement its annual report with additional loan-level data. That would allow policymakers to better assess the adequacy of the capital reserves.

Because Integrity Matters™

Jeffrey has spent the last three decades perfecting an Honest, Open and Transparent (HOT™) loan and closing process that is laser-focused on enhancing the consumer mortgage experience. By combining old-school, trustworthy customer service with real-time, mobile-friendly technology, he has successfully built thousands of loyal, raving fans.

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