Section VIII: Conclusions -- Compliance with the National Affordable Housing Act

According to our estimates for the base-case economic scenario, as of the end of FY 2008 the MMI Fund has an economic value of $12.908 billion and unamortized IIF of $429.634 billion, resulting in a capital ratio of 3.00 percent. Furthermore, we projected that during the next seven years the capital ratio would decline to 2.28 percent in FY 2011 and then increase to 2.90 percent by FY 2015. Therefore, we conclude that the Fund will continue to exceed the 2.0 percent minimum level required by NAHA. If the future experience is worse than what is projected in this Review, it is possible that the capital ratio would go below the 2 percent level.

Observed house price growth rates deteriorated significantly in FY 2007 and FY 2008 – the annualized rates were negative 0.23 and negative 1.44 percent during the second and third quarters of FY 2008, respectively. This was much worse than the rates forecasted by Global Insight, Inc. in August 2007 that were used in last year's Review. Global Insight's revised economic forecast for July 2008 projects the house price growth rate to turn deeply negative in the second half of FY 2008, and remain negative in FY 2009 and FY 2010. Specifically, Global Insight, Inc. forecasts that the OFHEO national house price index will decrease by 9.14 percent during FY 2008. The actual and forecasted downturn in the nation's housing market had a significant impact on the projected financial strength of the MMI Fund by reducing the economic value of the fund by $9.84 billion, leading to the year-end FY 2008 capital ratio of 3.00 percent. This represents a very severe decline of 3.40 percentage points from the 6.40 percent estimated for year-end FY 2008 in the FY 2007 Review.

The MMI Fund has been adversely affected by the fallout from the subprime situation even though FHA loans have different underwriting standards from subprime loans. However, the Fund cannot escape the impact of the national housing recession. It has been widely argued that housing prices may have been pushed too high due to the subprime lending activities in many areas. Meanwhile, the housing market recession during the past year may have been amplified by the high foreclosure rate of subprime mortgages. The subprime crisis may have also contributed to the tightening of national credit market, which further limits the demand for housing. As a result, the MMI Fund performance is indirectly negatively impacted by the subprime lending through the severity of the current housing recession. However, since FHA has lost substantial market share during the past few years, the reduced volume of the FY 2006 and FY 2007 books of business imply that the size of the negative effect is not as bad as it might have been. The FY 2008 book is much larger due to the contraction in subprime and conventional mortgage lending, enactment of the Economic Stimulus Act of 2008 that raised FHA-insured loan limits, and increased volume of conventional-to-FHA refinanced loans through the *FHASecure* expansion program. But given its large size and the worst housing downturn for a book of business over all the books studied in this Review, the FY 2008 book is projected to have a present value of negative $3.7 billion, the largest negative value for any books observed in our Reviews.

One of this year's actuarial model enhancements was to substitute a relative house price variable for the previous relative loan size variable for fully-underwritten FRM30, FRM 15, and ARM products to better reflect the policy changes allowing movement of FHA into the jumbo loan market during FY 2008. Another change is the incorporation of the risk-based premiums expected to be implemented via the FHA modernization initiative starting October 1, 2009. The new premium schedule proposed by FHA differs according to FICO-LTV combinations. With the implementation of the new premium schedule, this will enable FHA to charge upfront and annual premiums to better align with the credit risks of individual loans.

The share of loans with downpayment assistance from non-profit organizations has declined from the historical highs, but still accounts for 17.56 percent of the MMI Fund's insured portfolio in FY 2008. These loans experienced claim rates that are considerably higher than otherwise comparable non-gift loans. The passage of HERA prohibits FHA's endorsement of seller-financed downpayment assistance loans with credit approval on or after October 1, 2008. The effective enforcement of HERA will help improve the credit quality of the FHA portfolio, particularly the new books of business to be endorsed in the coming years.

Finally, the *FHASecure* Expansion Program to help some qualified subprime and conventional mortgage borrowers may change the volume, composition, and performance of FHA's future books of business. Its impact on the actuarial soundness of the MMI Fund will need to be carefully monitored in future Reviews.