Section VII: Qualifications and Limitations

The estimates presented in this Review require projections of events more than 30 years into the future. These projections are dependent upon a number of assumptions, including economic forecasts by Global Insight, Inc. and the assumption that FHA does not change its refund and premium policies. To the extent that the realized experience deviates from these or other assumptions, the actual results may vary, perhaps significantly, from our current projections.

Furthermore, our analysis is based on an extract of FHA's data warehouse as of March 31, 2007, as well as economic forecast information based on Global Insight's economic assumptions as of the beginning of August 2007. The volume and composition of the portfolio are further updated by two extracts of FHA data, as of May 31 and July 31, 2007. While we have reviewed the integrity and consistency of these data and believe the data to be reasonable, we have not audited them for accuracy. The information contained in this Review may not correspond exactly with other published analyses that rely on FHA data compiled at a different time or obtained from other data sources.

We identified the following limitations and issues for consideration or possible additional investigative analyses while conducting this Actuarial Review:

- Model responsiveness to changing economic conditions or market regime shifts

  The actuarial models used for this study are based on econometric regression techniques. Several key economic variables incorporated in the actuarial models drive the forecasts of economic values and capital ratios. These models are not time-series models and are therefore dependent upon the forecasts of future values of the economic predictors of loan performance. The parameter estimates for these models are based on a wide variety of economic conditions over the past 30 years. The model coefficients are reliable only when the existing market and policy regimes remain unchanged. Therefore, the forecasts presented in this study are long-term in nature, as is appropriate given the long-term period over which the cash flows modeled.

  Short-term variations in MMI Fund claim or prepayment rates are not predicted by these models, nor are other intermediate outcomes, such as delinquencies. It is not clear what conditions would cause such short-term variations to have a significant influence on the long-term forecasts. Further study in such short-term variations is challenged by lack of data availability and data consistency.

- Using the model to predict fiscal-period claims and prepayments

As discussed above in regard to model responsiveness, the actuarial models used for this study were not intended to predict short-term claims and prepayments for each fiscal period. Additional variables and/or alternative modeling approaches would be more effective to project short-term results. Those additional variables would also need to be predicted or modeled. Further study of short-term forecasts could be included in future annual actuarial studies to assess the potential for change in the MMI Fund's capital ratio or other adverse indications that might be predicted by short-term variables.

- Projection of concentration and performance of gift loans

  In the prior FY 2006 Review we assumed that the loans with gift letter from non-profit organizations would gradually diminish during the period from FY 2007 to FY 2009. This assumption was based on a ruling by the IRS disallowing non-profit organizations from receiving contributions from home sellers to be used as cash downpayment gifts to the buyer. However, recent data show that the volume of loans with gift letters from non-profit organizations remained high throughout FY 2006 and into early FY 2007. At the time this Review was being prepared, HUD issued a ruling, effective October 1, 2007, that prohibits the endorsement of loans that receive gift letter from a non-profit organization that is financially related to the seller of the collateral property. In light of this twin enforcement, the current actuarial review assumes that these high-claim-rate gift loans will quickly diminish and be totally eliminated by the end of FY 2008. However, there are still various opinions regarding the future of this type of loan currently under discussion by various policy makers. Continued close scrutiny is necessary regarding this issue.

- Using borrower credit rating data in the actuarial models

  Borrower credit scores (FICO scores) have proven to have significant predictive power for loan performance. However, one needs to understand that the credit score impacts in the models are estimated using two different sources of credit scores: (1) scores obtained from special historical sample data-collection efforts; and (2) scores directly reported by lenders to FHA upon loan closing. Adjustments to the models were included to account statistically for the different sources of credit score data, but given the limited number of years for which scores have been directly available for FHA loans continued monitoring of these differences in future years is warranted.

- Interpretation of how high the capital ratio should be before introducing reduced premiums, distributive shares or other features

Investigation into this issue should involve exploration of various actuarial metrics for assessing the strength of the capital ratio, particularly in terms of the viability of the Fund to withstand prolonged adverse economic conditions.

- The current Review depends on FHA's projection of the volume of future books of business

  A more comprehensive demand forecast model that incorporates the distribution of loans across loan types, LTV categories and regions, in addition to overall volume estimates, could enhance the reliability of the capital ratio projection of future fiscal years.