

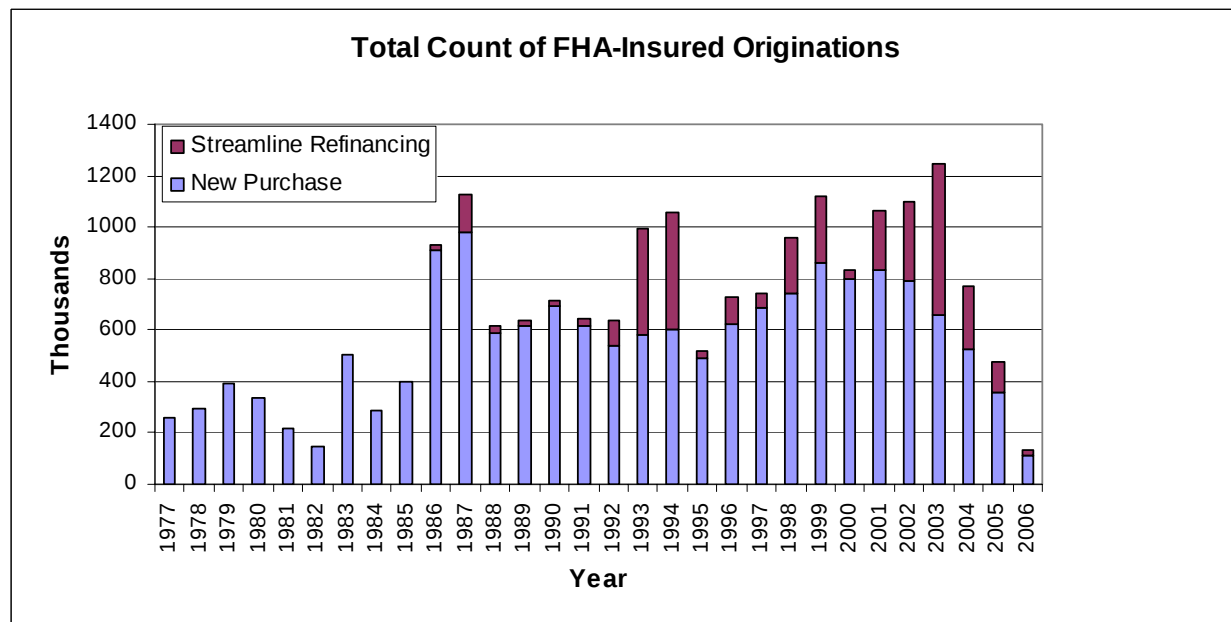
Section IV: Characteristics of the Fiscal Year 2006 Book of Business

This section takes a closer look at the characteristics of the FY 2006 book of business. The characteristic descriptions include: the analysis of loan origination volume and composition, the comparison of new purchase versus refinancing, and the distribution of loans by relative loan size and loan-to-value ratios. This section also examines and compares the FY 2006 book with previous books in order to gain insights into how the FY 2006 book is likely to influence future performance. Because the data used for this Review is an extract as of February 28, 2006, the characteristics for the FY 2006 book needed to be extrapolated from the later part of the FY 2005 originated loans.

A. Volume and Share of Mortgage Originations

In FY 2006, FHA is estimated to have insured about \$51.728 billion in single-family mortgages through the MMI Fund, bringing the fund's total unamortized IIF to about \$323.028 billion. Exhibit IV-1 shows the annual FHA originations count as well as the streamline refinancing count from FY 1977 through FY 2006.

Exhibit IV-1



Source: FHA data warehouse, February 28, 2006 extract.

Exhibit IV-1 shows that FHA's book of business dropped significantly in FYs 2004 and 2005 from its peak in FY 2003. The decline was mainly due to the decrease in streamline refinancing which fell 58.6 percent in FY 2004 from its high in FY 2003 and another 51.8 percent drop from FY 2004 to FY 2005. The volume of for-purchase mortgages also experienced a steady decrease since FY 2002.

Mortgage interest rates had reached a 30-year low over the FY 2003 to FY 2005 period, which has substantially improved housing affordability in the United States. Although the rapidly rising house prices during the same period partially offset the housing affordability, the highest number of homes sold in the nation's history took place over this three-year period. Specifically, the number of homes sold increased from FY 2002 to FY 2005 by about 28 percent. On the other hand, the home-purchase loans endorsed by FHA dropped by 43 percent during the same period. The same divergence was observed in dollar terms. The market dollar volume of home sales rose by 66 percent, while the FHA for-purchase endorsement dollar volume dropped by 55 percent. Exhibit IV-2 shows the mortgage origination volume and FHA's market share.

The divergent trend between the number of houses sold and number of loans FHA endorsed led to the substantial decrease in FHA's market share in recent years. FHA's share by loan count decreased from 12.22 percent in FY 2002 to 4.09 percent in FY 2005 and could be as low as 3.81 percent for FY 2006. When measured by dollar volume, the estimated FHA market share for FY 2006 is about 1.73 percent, down from 7.87 percent in FY 2001.

Exhibit IV-2

FHA's Market Shares of New Insurance Counts and Volumes National Home Purchase Market						
Fiscal Year	Number of Mortgages Originated (000)			Volume of Mortgage Originated (billions, current dollars)		
	FHA ^a	Market ^b	FHA Share (%)	FHA	Market	FHA Share (%)
1989	678	4,245	15.98	43	424	10.10
1990	742	4,100	18.05	49	519	9.51
1991	656	3,842	17.09	45	499	9.09
1992	597	4,123	14.47	43	547	7.77
1993	639	4,554	14.04	48	613	7.90
1994	652	4,987	13.07	52	696	7.42
1995	556	4,845	11.48	45	689	6.46
1996	688	5,289	13.00	58	784	7.43
1997	753	5,467	13.77	66	854	7.73
1998	790	6,084	12.99	71	1,004	7.12
1999	911	6,463	14.09	89	1,124	7.96
2000	858	6,335	13.55	89	1,157	7.71
2001	872	6,405	13.61	96	1,221	7.87
2002	808	6,615	12.22	94	1,356	6.93
2003	657	7,148	9.19	80	1,578	5.08
2004	506	7,901	6.41	63	1,914	3.27
2005	346	8,454	4.09	42	2,247	1.89
2006 ^c	164	4,296	3.81	20	1,177	1.73

Source: Existing Home Sales are from the National Association of Realtors; FHA numbers are from HUD.

^a Home purchase loans endorsed by FHA under either the General Insurance Fund or the MMI Fund.

^b Total number of home sales in the nation.

^c FY 2006 data is for the October 2005 - February 2006 period.

Looking at the longer history shown in Exhibit IV-2, during the decade of 1992 to 2002, FHA's market share remained stable around 13 percent of the market in terms of the number of loans insured. Because of the smaller size of FHA-insured loans, FHA's market share by dollar volume was around 8 percent during the same time period. This relationship had been stable regardless of the total market volume and macroeconomic conditions.

The high rate of house price appreciation may have contributed to this decrease in the FHA market share. On September 5, 2006, the Office of Federal Housing Enterprise Oversight

(OFHEO) announced that home prices were 10.06 percent higher in the second quarter of 2006 than they were one year earlier.

In the same OFHEO report, average home prices rose 1.17 percent in the April-June period, compared with 3.65 percent in the second quarter of 2005, the lowest rate of appreciation since the fourth quarter of 1999. Higher interest rates and rising inventories of homes for sale are possible factors in the slowdown in house price appreciation. The cooling down of the housing market is consistent with Global Insight's forecast back in 2005. However, the housing boom lasted about one year longer than Global Insight forecasted. Should private mortgage lenders tighten their underwriting rules, FHA may regain market share during the next few years. However, the lower house price appreciation rate also implies higher mortgage claim risks. FHA will need to make sure the insurance premium is sufficient to cover the potentially high claim risk for the next few new books of business.

Another hypothesis raised by the mortgage industry is that the continuous expansion into the less-than-prime mortgage business by private mortgage lenders and private mortgage insurers could marginalize FHA's business volume and adversely affect the overall quality of loans endorsed by FHA. Again, such a hypothesis has not been carefully researched. In the rest of this section, we examine FHA's business concentration pattern to determine if there exist adverse quality indicators that were not incorporated into the actuarial models we developed for the MMI Fund.

B. Originations by Location

FHA insures loans in all parts of the U.S. About half of FHA's total dollar volume is concentrated in only ten states. Exhibit IV-3 illustrates the percent of FHA's total dollar volume originated in these ten states over FYs 2002 through 2006. The table includes the top 10 States during FY 2006 plus California.

Exhibit IV-3

Percentage of FHA Dollar volume Originated Between FY 2002 and FY 2006					
State	2002	2003	2004	2005	2006
Texas	8.35	9.27	11.42	13.54	13.65
Georgia	4.60	4.24	5.33	6.21	5.88
Ohio	3.52	3.40	3.81	4.24	4.96
Illinois	4.80	5.00	4.78	4.40	4.32
Indiana	2.51	2.66	2.94	3.60	4.03
Michigan	3.08	3.01	3.33	3.83	4.01
Colorado	4.98	5.53	4.99	4.60	3.75
N. Carolina	2.54	2.76	2.89	3.53	3.62
Florida	5.09	4.78	5.28	4.34	3.55
New Jersey	3.53	3.65	4.05	3.98	3.52
California ^a	12.20	8.89	5.19	2.33	1.51
% of Total	42.99	44.28	48.82	52.27	51.30

Source: FHA data warehouse, February 28, 2006 extract.

^a California had been one of the top 10 States in FHA's business till FY 2004. It was ranked 19th in FY 2005. During the first quarters of FY 2006, its rank dropped to 23rd in FHA's origination volume.

Using this year's ranking, Indiana, Michigan and North Carolina appear for the first time in the top ten list. We also see that California continued to experience a decrease in percentage share while Texas has maintained the top percentage share of over 13 percent. The rapid growth in California house prices during the past few years has pushed more home mortgages over the FHA loan size limit.

The historical house price growth rates at the MSA level is captured by our econometric model through the probability of negative equity variable. As a result, the geographical concentration of the MMI Fund and the historical house price growth rates of the various locations have been reflected in the actuarial simulation model.

C. Originations by Mortgage Type

Exhibit IV-4 shows historically that the 30-year FRM made up almost all of FHA's business. This trend began to change in the early 1990s when FHA introduced the adjustable-rate mortgage (ARM) and the streamline-refinancing mortgage (SR). Gradually, adjustable-rate and streamline refinancing mortgages took on a bigger share of the annual originations. For the past few years, it is clear from Exhibit IV-4 that the 30-year FRM share has decreased relative to SRs, with FY 2003 being the extreme case. As indicated by Exhibit IV-4, this trend was reversed as market interest rates have increased recently. For the first two quarters of the FY 2006 book of

business, 30-year FRMs increased from 67 percent to 79 percent while 30-year SRs dropped from 18 percent to 14 percent.

The 15-year FRMs and 15-year SRs continue to be minor product types in the MMI portfolio. With relatively low interest rates, some borrowers were able to convert a previously borrowed 30-year mortgage into 15 years without much increase in the payment burden. However, for the vast majority of cash-out refinancers, the 30-year FRM remains the popular choice.

FHA's ARM share has decreased from its mid-1990s high to an insignificant level during the 2000s. With the expectation that interest rates will continue to rise in the future, borrowers see an opportunity to lock in their mortgage rates for the long term by choosing 30-year FRMs. This tends to keep the portion of adjustable-rate loans small. However, there could still be some income-constrained borrowers who need the lower initial payments of ARMs in order to qualify for or afford the mortgage.

The dynamics of the MMI Fund concentration among product types is captured by our econometric models with six different models separately fitted to the historical performance of the individual product types.

Exhibit IV-4

FHA-Insured Originations By Mortgage Type (Percentage of FHA-Insured Mortgages by Dollar Volume)						
Fiscal Year	Purchase Mortgages			Streamline Refinancings		
	30-Year	15-Year	ARMs	30-Year	15-Year	ARMs SRs
	FRMs	FRMs		SRs	SRs	
1977	99.85	0.15	n/a	n/a	n/a	n/a
1978	99.91	0.09	n/a	n/a	n/a	n/a
1979	99.94	0.06	n/a	n/a	n/a	n/a
1980	99.90	0.10	n/a	n/a	n/a	n/a
1981	99.84	0.15	n/a	n/a	n/a	n/a
1982	99.62	0.38	n/a	n/a	n/a	n/a
1983	93.71	6.28	n/a	n/a	n/a	n/a
1984	94.30	5.69	0.01	n/a	n/a	n/a
1985	92.06	7.78	0.14	0.02	n/a	n/a
1986	89.02	8.10	0.74	1.81	0.33	0.00
1987	80.57	4.99	1.47	11.09	1.82	0.06
1988	86.35	3.60	4.98	4.59	0.45	0.03
1989	92.97	2.70	1.52	2.62	0.18	0.00
1990	93.08	2.77	0.80	3.10	0.25	0.00
1991	88.15	3.12	4.43	3.67	0.58	0.04
1992	66.63	2.46	16.29	11.00	2.22	1.40
1993	45.29	1.98	12.05	30.45	8.02	2.21
1994	42.01	1.58	16.88	28.44	8.28	2.81
1995	64.87	1.22	29.18	3.01	1.00	0.72
1996	60.15	1.04	25.19	9.59	1.97	2.06
1997	56.52	0.94	34.72	4.28	0.86	2.68
1998	63.73	0.89	11.71	19.61	1.65	2.40
1999	72.01	0.91	4.16	19.91	1.96	1.05
2000	84.83	0.65	10.92	2.58	0.32	0.69
2001	74.17	0.77	2.00	21.44	0.81	0.81
2002	65.11	0.93	5.79	22.96	1.86	3.36
2003	48.92	0.92	3.64	39.45	3.53	3.54
2004	61.42	1.04	8.22	21.73	2.75	4.84
2005	67.28	1.08	8.25	18.56	1.56	3.28
2006 ^a	79.20	1.25	3.35	14.57	1.01	0.62

Source: FHA data warehouse, February 28, 2006 extract.

^a Based on partial year data.**D. Initial Loan-to-Value Distributions**

Based on the econometric studies of mortgage behavior, a borrower's equity position in the mortgaged house is one of the most important drivers of default behavior. The larger the equity

position a borrower has, the greater the incentive to avoid default on the loan. The initial LTV is an inverse measure of the borrower's equity at the origination date. Exhibit IV-5 shows the distribution of mortgage originations by initial LTV categories.

Exhibit IV-5

Distribution of Originations by Initial LTV Category (Percentage of FHA-Insured Mortgages by Dollar Volume)						
Books of Business	Unknown LTV	≤ 80%	> 80% ≤ 90%	> 90% < 95%	≥ 95% < 97%	≥ 97%
1977	11.66	5.19	14.44	35.67	26.05	7.00
1978	18.07	4.89	12.38	29.49	28.91	6.26
1979	19.76	7.10	16.55	31.05	22.51	3.03
1980	11.45	12.75	27.86	26.04	19.83	2.07
1981	26.96	11.87	26.88	17.70	15.44	1.15
1982	16.54	19.14	26.68	20.73	16.07	0.83
1983	20.42	19.05	24.39	20.22	14.68	1.25
1984	2.78	16.22	26.16	24.26	23.55	7.03
1985	1.11	16.27	31.19	25.24	23.55	2.64
1986	0.56	18.36	30.29	25.29	22.50	2.99
1987	0.18	15.71	27.22	27.53	26.24	3.12
1988	0.13	8.07	19.70	33.05	34.35	4.70
1989	8.93	6.81	16.85	30.94	32.05	4.42
1990	11.94	6.16	16.19	29.84	31.48	4.40
1991	1.79	5.60	15.72	28.09	31.69	17.11
1992	1.75	4.36	13.91	27.84	38.53	13.60
1993	0.28	3.48	12.40	25.35	33.47	25.02
1994	0.21	3.26	11.24	24.16	33.42	27.71
1995	0.06	2.69	10.19	24.34	34.58	28.14
1996	0.02	2.62	10.43	25.46	35.31	26.16
1997	0.01	3.09	10.87	26.12	35.19	24.71
1998	0.01	3.28	11.19	26.30	35.76	23.46
1999	0.00	2.91	8.10	12.92	31.25	44.81
2000	0.00	2.25	5.86	6.53	32.94	52.42
2001	0.00	2.94	6.46	5.60	26.69	58.32
2002	0.00	3.33	6.61	5.30	26.00	58.76
2003	0.00	4.31	7.15	5.38	26.49	56.67
2004	0.00	4.45	7.32	5.72	25.90	56.61
2005	0.01	4.66	7.62	5.68	24.49	57.54
2006 ^a	0.46	5.94	8.81	6.82	23.83	54.15

Source: FHA data warehouse, February 28, 2006 extract, and the December 2003 extract prepared for FHA's external auditor

^a: Based on partial year data.

As Exhibit IV-5 indicates, the distribution among initial LTV categories remained stable during the 2000s. About 54 percent of the mortgages originated in FY 2006 have LTV ratios of 97 percent or more and 83 percent have LTV ratios 95 percent or more. These high-LTV percentages are up dramatically compared to previous years. The same percentages in FY 1998, *e.g.*, were 23 and 59 percent, respectively, with the percentages relatively stable in the 1990s at the lower levels. This upward shift is a very significant factor in the higher risk of the more recent books.

The LTV concentration of individual books of business affects our econometric models in two respects. First, it serves as the starting position for updating the probability of the negative equity variable. Second, the initial LTV itself is also included in the model to capture potential behavioral difference among borrowers self-selected into different initial LTV categories.

E. Initial Loan Size Distributions

One of our model's explanatory variables is the loan size category. This variable is identified by comparing the size of a particular loan with the average loan size of all other FHA insured loans originated in the same period and within the same location. Existing literature indicated that using *relative* loan size categories eliminates the upward bias that occurs when classifying loans in higher-cost areas using *absolute* loan size categories. The upper limits for categories one through six are based on breakpoints determined by a percentage of the average loan amount in each state.

Exhibit IV-6 shows the percentage of new originations within each relative loan size category. Overall, the FY 2006 book of business is similar to the FY 2005 book of business. Over the years, the largest loan size category (>140 percent of the average loan size) has been gradually increasing. Most of the increase results in a decrease in the percentage in the 80-100 percent and 120-140 percent loan size categories.

FHA experience indicates that larger loans tend to perform better in two respects compared with smaller loans in the same geographical area, all else being equal. Larger loans incur claims at a lower rate, and in those cases where a claim occurs, the loss severity tends to be lower. The loss severity is defined as the percentage of a claim amount not recovered through the sale of the conveyed property or mortgage note. Those houses associated with larger FHA loans tend to be in the average house price range for their surrounding areas. Since this market is relatively liquid and there are a relatively large number of these similar-quality homes in the area, the house price volatility of these houses tends to be relatively smaller in comparison to the house price volatility of the extremely low- and high-priced houses. With similar initial LTVs, the higher priced houses tend to be associated with larger loan amounts. In addition, because a large portion of claim costs are fixed and do not vary with regard to loan or property value, larger loans are generally accompanied by lower loss severity rates.

Exhibit IV-6

Distribution of Originations by Relative Loan Size Category (Percentage of FHA-Insured Mortgages by Dollar Volume)						
Book of Business	0-60% of Average Loan Size	60-80% of Average Loan Size	80-100% of Average Loan Size	100-120% of Average Loan Size	120-140% of Average Loan Size	>140% of Average Loan Size
1977	3.11	11.76	24.44	31.15	21.04	8.50
1978	3.53	12.16	25.11	27.33	21.53	10.34
1979	3.30	11.11	24.35	30.95	21.79	8.51
1980	3.51	10.71	23.48	33.87	19.54	8.89
1981	4.08	11.05	23.50	29.58	19.46	12.33
1982	4.92	11.31	21.31	27.75	20.77	13.94
1983	4.19	11.48	22.36	28.27	22.10	11.60
1984	4.31	11.70	22.28	28.21	21.28	12.23
1985	4.27	11.62	21.91	28.39	23.75	10.06
1986	3.60	11.48	23.02	30.17	23.98	7.76
1987	3.51	11.78	23.14	29.51	23.88	8.16
1988	4.22	12.18	21.71	28.58	21.36	11.94
1989	4.51	12.37	21.40	26.23	21.28	14.21
1990	4.79	12.64	21.42	25.59	18.93	16.63
1991	4.80	12.55	21.39	24.33	21.40	15.53
1992	4.43	12.35	21.97	25.62	21.60	14.03
1993	3.92	12.31	23.16	26.89	20.91	12.82
1994	4.33	12.81	22.34	24.93	20.31	15.27
1995	4.74	12.98	20.93	24.59	20.85	15.90
1996	4.56	12.87	21.01	25.27	21.54	14.74
1997	4.63	12.92	20.49	25.78	21.67	14.50
1998	4.29	12.53	21.14	27.71	21.53	12.79
1999	4.63	12.94	21.45	25.82	19.08	16.08
2000	5.27	12.82	20.80	23.98	18.93	18.19
2001	4.93	12.31	22.02	24.85	19.11	16.78
2002	5.14	12.29	21.72	24.52	18.88	17.46
2003	5.07	12.22	21.81	25.09	18.86	16.96
2004	5.89	12.46	20.10	22.98	18.77	19.80
2005	5.86	12.76	19.57	22.77	18.87	20.17
2006 ^a	5.83	13.00	19.26	22.86	18.60	20.44

Source: FHA data warehouse, February 28, 2006 extract

^a: Based on partial year data.

Exhibit IV-7 provides a detailed breakdown of average loan sizes by relative loan size category.

Exhibit IV-7

Average Loan Size by Relative Loan Size Category (\$)						
Books of Business	0-60% of Average Loan Size	60-80% of Average Loan Size	80-100% of Average Loan Size	100-120% of Average Loan Size	120-140% of Average Loan Size	>140% of Average Loan Size
1977	13,661	19,547	25,786	31,229	36,488	39,171
1978	16,472	24,130	31,025	37,506	45,930	48,842
1979	18,761	28,089	36,743	45,562	52,125	54,383
1980	20,442	30,782	40,523	50,523	56,285	60,804
1981	21,628	33,059	43,952	53,915	60,820	68,337
1982	22,480	34,127	45,171	55,558	64,506	71,734
1983	25,198	37,121	48,417	59,331	68,803	76,628
1984	25,884	38,582	51,016	62,994	72,514	79,002
1985	28,069	41,754	55,205	68,137	79,415	83,604
1986	29,858	43,557	56,582	69,924	80,835	86,007
1987	30,501	43,639	56,555	69,984	81,179	86,562
1988	29,393	42,257	55,079	69,460	79,570	85,960
1989	30,081	43,627	56,658	71,003	82,270	90,737
1990	31,839	45,965	59,911	74,427	84,879	98,441
1991	32,971	47,807	62,089	76,631	90,813	100,462
1992	34,463	49,531	64,097	78,689	92,962	104,378
1993	36,886	52,567	67,545	81,947	96,233	112,185
1994	37,262	53,212	67,804	82,168	97,643	115,736
1995	39,377	56,163	71,450	87,826	104,508	121,520
1996	41,859	59,830	75,913	93,397	111,343	128,075
1997	43,632	62,578	78,872	97,699	116,303	134,245
1998	45,845	65,642	82,831	102,641	121,192	140,383
1999	48,819	69,380	87,720	108,052	127,109	154,367
2000	51,649	72,811	93,313	114,989	134,905	165,774
2001	55,875	79,060	101,780	125,040	144,338	179,762
2002	57,895	81,952	105,281	128,923	148,706	188,692
2003	59,776	85,098	109,211	133,219	153,625	195,773
2004	59,128	83,960	108,092	132,409	153,702	197,049
2005	58,281	84,623	109,196	133,675	156,132	196,950
2006 ^a	59,138	86,423	111,528	136,459	159,667	200,207

Source: FHA data warehouse, February 28, 2006 extract

^a: Based on partial year data.

Despite the record high national house price growth rate revealed by the OFHEO house price index during the past three years, the average loan size of FHA business remained virtually unchanged from FY 2003.

F. Initial Contract Interest Rate

Exhibit IV-8 shows the average contract rate by mortgage type since FY 1989. Over the years, the average contract rate has been gradually decreasing up to FY 2005 and it started rising in FY 2006 for all loan types.

Research has found that, in general, an FRM with a lower contract rate tends to experience fewer claims, but they also tend to prepay more slowly. Slower prepayment rates imply that mortgages are exposed to default risk for longer periods of time. Recent research has confirmed the competing risk theory of prepayments and claims. That is, a borrower can only exercise either the prepayment or the default option. Under an environment in favor of prepayments, the conditional claims rate would be lower than otherwise similar situations. Likewise, during a housing recession where default is more likely, the conditional prepayment rate also tends to be low. This competing risk nature of prepayments and claims drives the performance of FRMs in particular. As the interest rate is expected to rise, the prepayment rate of the FY 2006 book would be low, which would leave more loans subject to claim risk for a longer period of time. Meanwhile, the low house price growth rate forecasted by Global Insight, Inc. also implies that the claim probability could rise from the past few books of business. As a result, the FY 2006 book of business is expected to experience higher cumulative claim rates than other books originated in the previous few years.

Exhibit IV-8

Average Contract Interest Rate by Loan Type (Percent)							
Fiscal Year	30-Year FRMs	15-Year FMRs	AMRs	30-Year SRs	15-Year SRs	ARM SRs	SRs Average
1989	10.06	9.87	9.08	11.16	10.22	9.18	10.07
1990	9.69	9.48	8.54	10.70	9.95	8.86	9.71
1991	9.46	9.15	7.56	10.09	9.31	7.74	9.40
1992	8.54	8.35	6.47	8.91	8.37	6.51	8.26
1993	7.76	7.41	5.87	8.16	7.58	6.27	7.64
1994	7.57	7.14	6.06	7.75	7.42	6.08	7.36
1995	8.39	8.25	7.18	8.67	8.69	7.32	8.10
1996	7.84	7.57	6.49	7.98	7.65	6.75	7.53
1997	7.97	7.77	6.53	8.23	7.97	6.77	7.51
1998	7.37	7.22	6.12	7.55	7.16	6.45	7.25
1999	7.24	7.00	6.00	7.16	6.88	6.05	7.16
2000	8.29	8.08	6.95	8.32	8.04	6.30	8.16
2001	7.56	7.16	6.19	7.41	6.85	6.12	7.49
2002	7.00	6.57	5.28	6.95	6.41	5.31	6.84
2003	6.08	5.54	4.37	6.01	5.48	4.44	5.91
2004	6.12	5.59	4.46	5.99	5.52	4.39	5.88
2005	5.92	5.65	4.79	5.85	5.64	4.68	5.79
2006 ^a	6.05	5.93	5.19	6.03	5.90	5.05	6.02

Source: FHA data warehouse, February 28, 2006 extract.

^a: Based on partial year data.

G. Downpayment Assistance through Gifts

FHA's database started tracking the sources of loans with downpayment gift supports in FY 1998. Exhibit IV-9 shows the distribution of MMI loans by gift source.

Exhibit IV-9 shows that virtually all downpayment gifts prior to FY 2000 were funded by the borrower's relatives. However, starting FY 2000, there was a rapid increase in the share of loans with gift letters from non-profit, religious, or community entities. This concentration reached about 10 percent by FY 2003 and increased dramatically to 23.5 percent in FY 2005 and 25 percent in FY 2006.

Exhibit IV-9

Concentration of Loans with Gift Letter by Sources (Percent)^a					
Origination Year	No Gift	Relative	Non-profit, Religious, or Community	Government Assistance	Employer
1998	77.60	21.87	0.19	0.31	0.03
1999	82.20	16.32	0.55	0.86	0.06
2000	77.17	18.81	1.83	2.10	0.09
2001	83.23	11.08	4.26	1.36	0.07
2002	82.26	9.15	7.05	1.48	0.06
2003	81.35	7.41	9.76	1.42	0.06
2004	70.24	9.59	18.05	2.04	0.08
2005	63.88	9.49	23.52	3.03	0.08
2006 ^b	61.31	9.62	25.10	3.87	0.10

Source: FHA data warehouse, February 28, 2006 extract.

^a In percentage of all MMI Fund endorsed loans, including purchase and refinance loans. The concentration rate of gift loans would be much higher if refinance loans were excluded from this calculation.

^b Based on partial year data.

With the significant number of loans receiving gifts for downpayments and the aging of these loans, we conducted a closer investigation of the performance of these gift loans. Exhibit IV-10 shows the cumulative claim rates realized on loans by gift source and origination year based on the FHA data extract as of the end of February 2006.

Exhibit IV-10

Cumulative Claim Rates of Loans with Different Gift Sources (Percent)					
Origination Year	No Gift	Relative	Non-profit, Religious, or Community	Government Assistance	Employer
1998	4.64	8.04	7.50	9.35	9.12
1999	4.55	7.59	12.16	11.39	8.15
2000	5.70	8.01	15.10	12.27	8.80
2001	4.18	5.67	13.66	11.25	7.05
2002	2.78	3.37	9.71	7.42	4.93
2003	1.45	1.91	5.99	4.70	2.62
2004	0.80	0.90	2.66	1.43	1.37
2005	0.10	0.09	0.35	0.15	0.25

Source: FHA data warehouse, February 28, 2006 extract.

Holding everything else the same, we find those non-relative gift loans performed worse than the loans without gifts across all origination years. In order to reflect this growing business concentration and the different performance of loans with different sources, we refined our econometrics model by incorporating a series of categorical variables to reflect this important development. As shown in Appendix A, the estimated coefficients of these gift-source variables are both economically and statistically significant.

Among the different gift letter sources, non-profit organization sources appear to have the highest cumulative claim rates for almost all origination years. A recent report by GAO pointed out that the gift letter program might have been misused by many non-profit organizations that are funded by home sellers. Subsequently, a ruling by IRS specifically stated that an organization that receives funding from home sellers and then passes the funds on to the buyers in the form of downpayment gifts is no longer qualified for tax exempt status and may lose its non-profit organization status. IRS expects to eliminate all non-profit organizations that currently are involved in the above-mentioned activities with the next two years. If this ruling is effectively enforced, we should see significantly fewer loans receiving downpayment assistance from non-profit organizations. This is likely to improve the credit quality of future books of business.