U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

ANNUAL REPORT TO CONGRESS
Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund
Fiscal Year 2014

November 17, 2014

FEDERAL HOUSING ADMINISTRATION

80 Years

YOUR PARTNER IN OPPORTUNITY

Annual Report to Congress Regarding the Financial Status of the Mutual Mortgage Insurance Fund Fiscal Year 2014

U.S. Department of Housing and Urban Development

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Secretary’s Foreword

It is a pleasure to present my first annual report on the financial status of the Federal Housing Administration’s (FHA) Mutual Mortgage Insurance Fund (MMIF). This year’s report shows that FHA successfully strengthened the Fund while continuing to deliver on its core mission of serving responsible buyers.

The value of the Fund has improved significantly, now standing at $4.8 billion. The increased economic value represents a capital reserve ratio of 0.41. This improvement shows tremendous progress, especially considering that the Fund had a *negative* value of $16.3 billion just two years ago. The two-year gain in Fund value is an impressive $21 billion. The performance of the portfolio has improved dramatically in a short period of time. Foreclosure starts are down 63 percent since the height of the crisis and recoveries to the Fund have improved 68 percent from their lowest level– saving billions of dollars. While FHA must still respond to challenges presented by legacy books and market volatility, the independent actuary’s report demonstrates that FHA is firmly on the right track and is projected to continue improving.

This year, FHA marked 80 years of tremendous service to our nation. It’s provided generations of Americans with a ticket to the middle class. In addition, by continuing to provide mortgage insurance during tough economic times, FHA has helped our economy.

The Federal Housing Administration again played this critical role in our most recent housing market recovery. At the depths of the economic crisis, when financial institutions stopped lending, FHA quickly stepped up to keep credit flowing. And as independent economists have noted, if not for FHA, the housing market would have experienced a much steeper decline.

This role was not without stress to the MMIF – and last year FHA required a mandatory appropriation from the U.S. Treasury. However, FHA has already taken, and continues to take, aggressive and effective steps to strengthen the Fund and improve its ability to respond effectively to a changing market.

As the independent actuary's review shows, FHA is delivering on its mission in a way that protects and enhances the health of the Fund. These continued improvements to the performance and long term health of the Fund are good news for American families and the housing market as a whole. As the housing market gets stronger, our challenge now is to help more Americans participate in this growth and do it in a way that's responsible. As a critical force in the housing market, FHA can do more to encourage that recovery. Released in May, FHA's *Blueprint for Access* outlines the ways FHA is expanding access responsibly, using housing counseling and improved quality assurance and risk management practices.

Achieving a turnaround of the MMIF during challenging fiscal times takes tremendous work and discipline. I especially want to thank outgoing Federal Housing Commissioner Carol Galante, and the entire FHA team, for their dedication and commitment which has resulted in such remarkable progress. We have successfully weathered the storm, and will continue to make important strides to strengthen FHA and stabilize the broader housing market. Looking back on FHA's 80 years, I can unequivocally state that it has been, and will continue to be, a "partner in opportunity" for the American people for generations to come.

Julián Castro
Secretary

U.S. Department of Housing and Urban Development

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Executive Summary

This Administration has made a number of necessary and fundamental changes to strengthen FHA and confront the challenges facing the agency. These changes have helped FHA to address the significant losses created by the 2007-2009 books of business while also putting FHA on a more sustainable path to fulfill its dual mission of providing access to mortgage credit for underserved borrowers and acting as a countercyclical force in times of economic stress. To date, this Administration has actively engaged in protecting and strengthening FHA's business practices by:

- Making major programmatic adjustments, examples include:
  - Working with Congress to eliminate the seller-funded down-payment assistance program
  - Enhancing the streamline refinance program
  - Modifying down-payment and credit score requirements
  - Introducing the HECM Saver product and adjusting HECM borrowing limits
  - Consolidating and updating the agency's condominium policy

- Installing a new risk management framework, examples include:
  - Creating the Office of Risk Management
  - Strengthening FHA's underwriting requirements
  - Implementing a new loss mitigation waterfall
  - Expanding the use of real estate owned (REO) alternatives
  - Enhancing enforcement of FHA lenders
  - Updating the agency's quality control requirements and surveillance capabilities

- Restructuring pricing to better manage risk and capitalize the fund, examples include:
  - Increasing the required upfront and annual Mortgage Insurance Premiums (MIPs)
  - Revising FHA's premium cancellation policy

These changes are fostering a turnaround in the fundamental health of the Mutual Mortgage Insurance Fund (MMIF, MMI Fund or Fund). They have improved the overall economic value of the Fund by $6.1 billion in the last year alone, taking it from a value of negative $1.3 billion at the end of FY 2013 to positive $4.8 billion according to the FY 2014 independent actuarial estimate.

While the hard work undertaken by this Administration must continue, these changes have already enabled FHA to better serve borrowers who need FHA support – primarily first-time homebuyers and low-wealth households – while simultaneously re-building the MMI Fund and preparing for future periods of economic stress.

COMPOSITION AND PERFORMANCE OF FHA MORTGAGES

This Administration's changes are leading to a stronger FHA while remaining focused on delivering the agency's core mission. During FY 2014:

- The number of families with an FHA mortgage stood at more than 7.7 million

- FHA supported more than 480,000 families in buying their first home. These are families that likely would otherwise not be served by the conventional mortgage market. The total number of first-time homebuyers that FHA has insured over the past three years now totals 1.6 million.

- FHA helped more than 477,000 families avoid foreclosure this past year through its loss mitigation home retention servicing tools. Total mitigation actions have exceeded 1.3 million over the last three years.

- In recent years FHA has sought to refocus on its core market while reducing its footprint in the overall mortgage market, enabling private sector credit sources to return to the mortgage market and FHA to recede from its expanded countercyclical role.

- FHA endorsements have now fallen from a peak of 1.8 million loans in FY 2009 to approximately 786,000 in FY 2014. This is a 57 percent reduction, taking FHA closer to the lower levels activity levels seen just prior to the housing bubble.

- The substantial drop in forward loan endorsements in FY 2014 was driven by the sharp decline in refinance activity. Previously many homeowners refinanced mortgages when the Federal Reserve supported low interest rates during the nation's economic crisis. The increase in interest rates during 2014 significantly limited attractive refinancing opportunities.

- The volume of conventional-to-FHA refinancing (where FHA is insuring refinances of conventional loans) has fallen from its peak of 469,000 in FY 2009 to 55,000 in FY 2014, a decline of nearly 90 percent.

As FHA's market activity shifts back to its core market, overall portfolio credit performance continues to strengthen.

- FHA's new loss mitigation waterfall has increased home retention activity by three percent, with FHA Home Affordable Modification Program (HAMP) activity increasing over 130 percent.

- Serious delinquency rates over the past year have fallen from 8.2 percent to 7.1 percent, on a seasonally adjusted basis. This is an aggregate decline of 13 percent.

STATUS OF THE MUTUAL MORTGAGE INSURANCE FUND

This year's independent actuarial results confirm that the Fund remains on the positive trajectory begun in 2013 despite the fact that legacy losses continue to be a drag on the portfolio (particularly from the 2007–2009 books of business). Their estimates illustrate that:

- The Fund's overall Economic Net Worth has improved by $6.1 billion, from negative $1.3 billion to positive $4.8 billion, while the Capital Ratio has improved from negative 0.11 percent to positive 0.41 percent.

- The economic value of the forward loan portfolio improved by $13.8 billion, from negative $7.9 billion to positive $5.9 billion, with a corresponding improvement in the capital ratio of the forward portfolio to 0.56 percent.

- The economic value of the HECM portfolio deteriorated from positive $6.5 billion to negative $1.2 billion, with a corresponding decline in the HECM capital ratio to -1.20 percent.

CAPITAL RESTORATION PLAN

The actions this Administration has taken have been vital to putting the Fund on solid footing for the future. Through a wide range of policy and pricing changes, newer cohorts have provided additional capital needed to cover losses on legacy books of business. As a result, the Fund is expected to continue to accumulate capital. The independent actuary expects the Fund to reach the required two percent capital reserve ratio in FY 2016. The Fund is also expected to have an Economic Net Worth of $23 billion at the end of FY 2016, and more than $55 billion in FY 2019.

While this positive trajectory represents significant progress, FHA is focused on sustaining the velocity of the changes for the Fund. In order to maintain this momentum, FHA will center its attention on the following initiatives:

- Continued focus on aggressive loss mitigation and recovery actions to minimize legacy losses in the near term and reduce potential losses in the event of another economic downturn. FHA will continue to optimize REO alternatives and refine the utilization of its disposition strategies.

- Full implementation of a new Quality Assurance Defect Taxonomy to find a way to simplify and better communicate quality control results to FHA lenders and to increase the transparency of the process. FHA developed this framework around three key components: identifying defects, assessing the severity of the defects, and focusing on the sources and causes of the defects.

- Pursuing a supplemental performance metric that would compare a lender’s performance to a targeted risk mix that includes default and claim rates, as well as borrower credit scores. This metric would compare lender performance to FHA’s targeted rate, rather than to their peers.

- A number of initiatives to incorporate housing counseling into FHA single family lending programs under the umbrella name HAWK (Homeowners Armed With Knowledge). HUD has created a multi-office HAWK team of more than 50 people, and used research findings and other evidence to build policies that will both strengthen the MMIF as well as contribute to the sustainability of homeownership for families using FHA-insured products. The Office of Housing Counseling and the Office of Single Family Mortgage Insurance Programs are jointly leading the HAWK initiatives, which link HUD-approved housing counseling agencies to FHA origination and servicing policies.

- Additional changes to the HECM program to ensure that it is able to continue meeting is primary objective of assisting senior homeowners to age in place, and doing so in a fiscally responsible manner.

In addition to the administrative actions that HUD will take, Congressional action is also necessary to further strengthen FHA for the long term. Those changes include:

- Authority to better monitor and enforce lender compliance, including enhanced indemnification authority, expanded authority to terminate lender approval, and the ability to establish refined compare ratio requirements.

- Authority to transfer servicing from poorly performing to higher performing servicers.

- Reducing barriers to more effective risk management in areas such as aligning human capital management and other statutory operating rules with other financial regulators.

* * *

After 80 years, FHA continues to deliver on its dual mission of providing access to credit for underserved borrowers and acting as a countercyclical force in times of economic stress. Positive progress in this past year strengthens FHA's ability to continue delivering on this mission.

I. Composition and Performance of FHA Mortgages

As the nation continues its steady path towards economic stability following the end of the Great Recession, FHA continues its positive momentum. Throughout fiscal year 2014, FHA worked to implement policies aligned with the current economic environment and the Agency's countercyclical role in housing and mortgage markets. In FY 2014:

- FHA's actions were critical to supporting the housing market during the financial crisis. Studies estimate that if it were not for FHA's countercyclical role during the height of the crisis in 2006-2009 and through the progressive years of recovery to a stronger more stable housing market, home prices would have declined further than they did, which would have extended the length and scope of housing market recovery.

- FHA insured approximately 786,000 loans, including 595,000 purchase loans. Eighty-one (81) percent or 480,000 purchase loans made in FY 2014 were for first-time homebuyers. While FHA is only 23.4 percent of the purchase market, it accounted for approximately 47 percent of purchase mortgage financing for African American and Hispanic borrowers.

- FHA's policies helped to keep borrowers in their homes and avoid foreclosure. The loss mitigation waterfall[1] and asset disposition approaches substantially reduced losses on loans in default. FHA Home Affordable Modification Program (HAMP) activity increased more than two-fold from FY 2013. Monthly foreclosure starts fell 60 percent from a peak of approximately 30,000 in FY 2012 to fewer than 12,000 at the end of FY 2014.

- Lastly, the portfolio performance continues to improve at a strong pace:
  - Serious delinquency rates for the active portfolio fell from 8.2 percent in FY 2013 to 7.1 percent in FY 2014.
  - Recoveries on dispositions have improved by more than 5.5 percent of the loan unpaid balance at default. In particular, the recovery rates for the Distressed Asset Stabilization Program (DASP) improved to 64 percent in FY 2014 from 49 percent in FY 2013.

A. NEW ENDORSEMENTS AND PORTFOLIO CHARACTERISTICS – FORWARD PORTFOLIO

FHA endorsed approximately $135 billion in single-family loans in FY 2014 (Exhibit I-1). Through both purchase and refinance activity, FHA continued to perform a critical role in providing access to affordable mortgage financing for Americans underserved by private markets.

[1] Mortgagee Letter 2013-32

The substantial drop in Forward loan endorsements from $240 billion in FY 2013 to $135 billion in FY 2014 was driven by the sharp decline in refinance activity (Exhibit I-2). During the several years of Federal Reserve-supported low interest rates at the time of the nation's economic crisis, many homeowners had previously refinanced mortgages. This factor, combined with the increase in mortgage interest rates during 2014, significantly limited attractive refinancing opportunities. Overall Forward loan volume, inclusive of refinances, declined by 42 percent.

FHA refinance volumes fell 70 percent. FHA purchase volume was relatively more stable, falling by only 15 percent. The decline in volume tracks with a general trend in the industry.

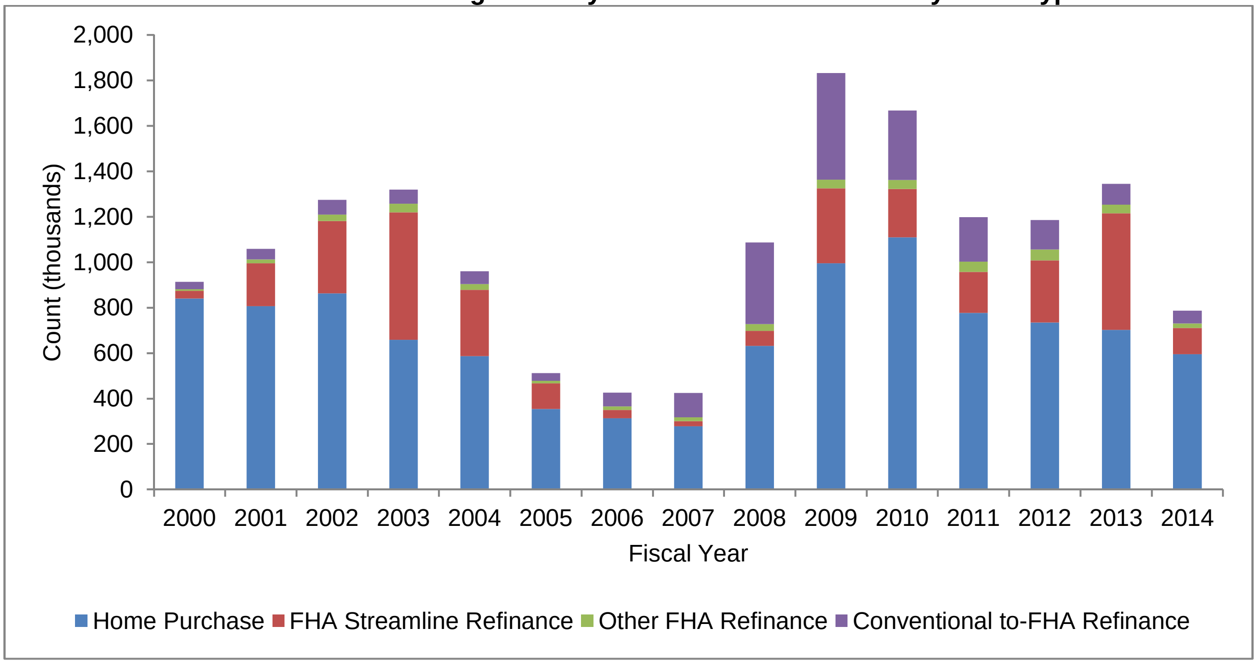
Exhibit I-1

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	839,869	34,443	6,780	32,007	913,099	$94
2001	806,818	188,422	17,230	46,207	1,058,677	$118
2002	862,898	318,245	28,525	64,475	1,274,143	$148
2003	658,640	560,891	37,504	62,694	1,319,729	$159
2004	586,110	291,483	26,147	56,695	960,435	$116
2005	353,844	113,062	11,840	33,581	512,327	$62
2006	313,998	36,374	14,722	60,397	425,491	$55
2007	278,395	22,087	16,504	107,739	424,725	$60
2008	631,655	66,772	28,510	360,456	1,087,393	$181
2009	995,550	329,437	38,070	468,942	1,831,999	$330
2010	1,109,580	212,896	39,595	305,538	1,667,609	$298
2011	777,428	180,265	44,560	195,560	1,197,813	$218
2012	733,863	274,061	47,593	129,221	1,184,738	$213
2013	702,416	511,843	39,083	91,507	1,344,849	$240
2014	594,997	115,038	20,959	55,359	786,353	$135

NOTES: This table shows all single-family endorsements, including a small number of loans today that are not obligations of the MMI Fund. This includes 203(k) Rehabilitation Home Mortgage Insurance and 234(c) Mortgage Insurance for Condominium Units. See Appendix B for expanded table with quarterly data.
SOURCE: U.S. Department of HUD/FHA, October 2014.

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



SOURCE: U.S. Department of HUD/FHA, October 2014.

1. Market Trends and FHA's Market Presence

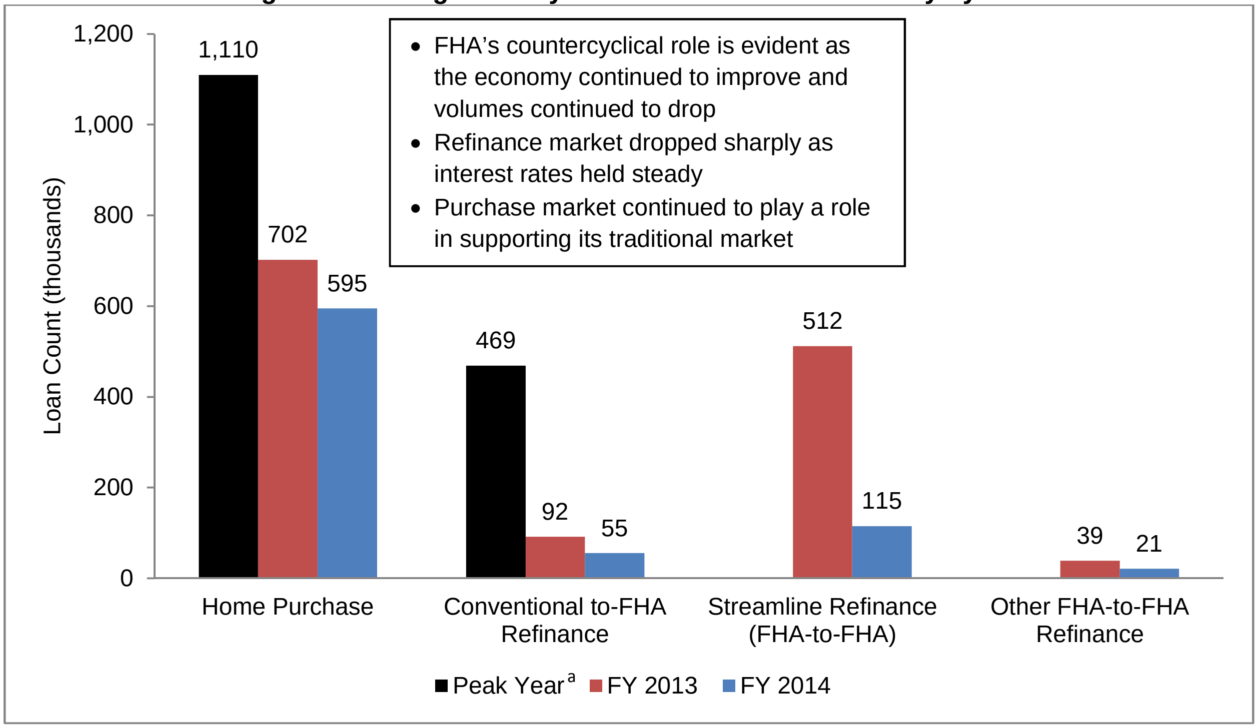
As FHA continues to emerge from the shadow of the Great Recession, there are two important observations to consider about FHA's role and market trends more generally:

- As in prior periods following deep economic crisis, FHA's footprint has receded. Its overall market share (purchase plus refinancings) has declined to about 10 percent from a peak of 18 percent in 2009. As is clear in Exhibit I-3, FHA's presence in the conventional-to- FHA refinance market has declined significantly.
- While FHA's endorsement activity has receded from the historic levels observed during the crisis, it does not mean that the market itself is back to health. Specifically, it is clear that the purchase market and first-time homebuyer market remain depressed as is illustrated in Exhibit I-4.

Over the past several years FHA has, as in prior periods of national economic challenge, played a vital countercyclical role in the housing market. The Agency expects to continue to provide support and credit access to a wide range of FHA eligible borrowers including first-time homebuyers who benefit from obtaining mortgages with low down payments and FHA insurance.

Exhibit I-3 shows the change in endorsement activity from its peak origination years to the past two fiscal years. Conventional-to-FHA refinancing has declined over 88 percent from its peak of 469,000 in FY 2009 to 55,000 in FY 2014.

Exhibit I-3
Change in FHA Single-Family Annual Endorsement Activity by Product

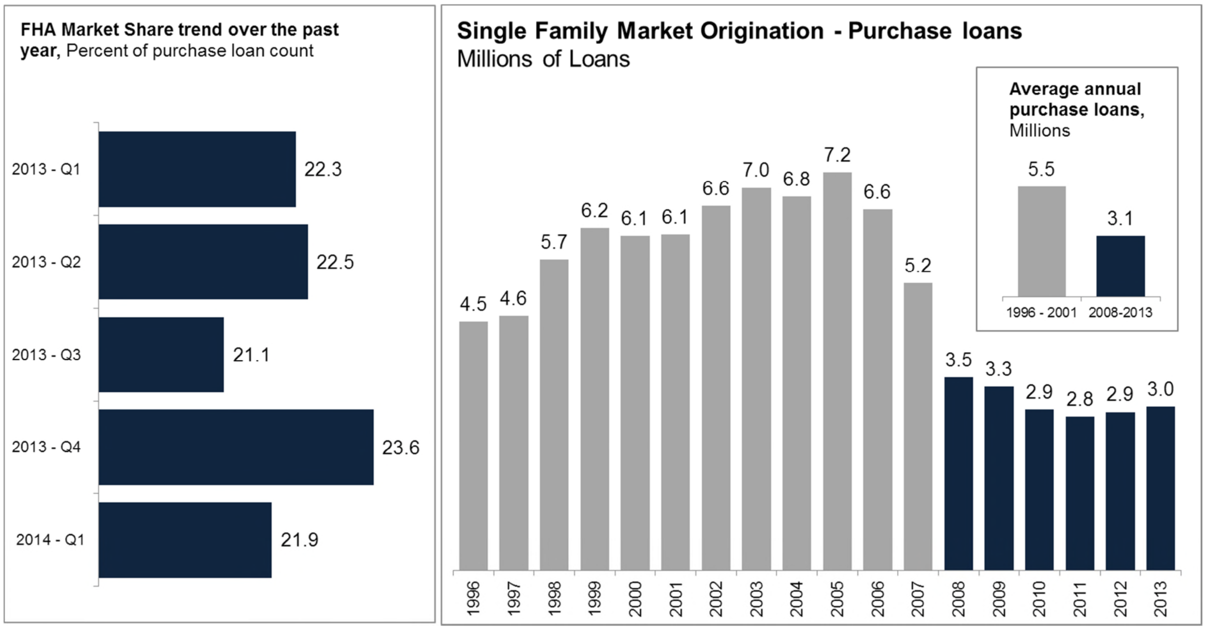


[a]Purchase peak occurred in FY 2010, Conventional-to-FHA Refinance peak occurred in FY 2009.
SOURCE: U.S. Department of HUD/FHA, October 2014.

While FHA's footprint is declining from its countercyclical levels, it is also clear that the purchase market has not returned to its normal levels. As evidenced in Exhibit I-4, purchase loan activity is 44 percent lower than it was during the 1996-2001 period prior to the housing bubble.

While FHA returns to its core focus on first-time homebuyers and low-income families, revitalizing the overall health of the purchase market will be an important focus. Ensuring that borrowers who qualify for an FHA loan have access to affordable homeownership is a critical priority.

Exhibit I-4
FHA's Market Share and Overall Purchase Market Trends



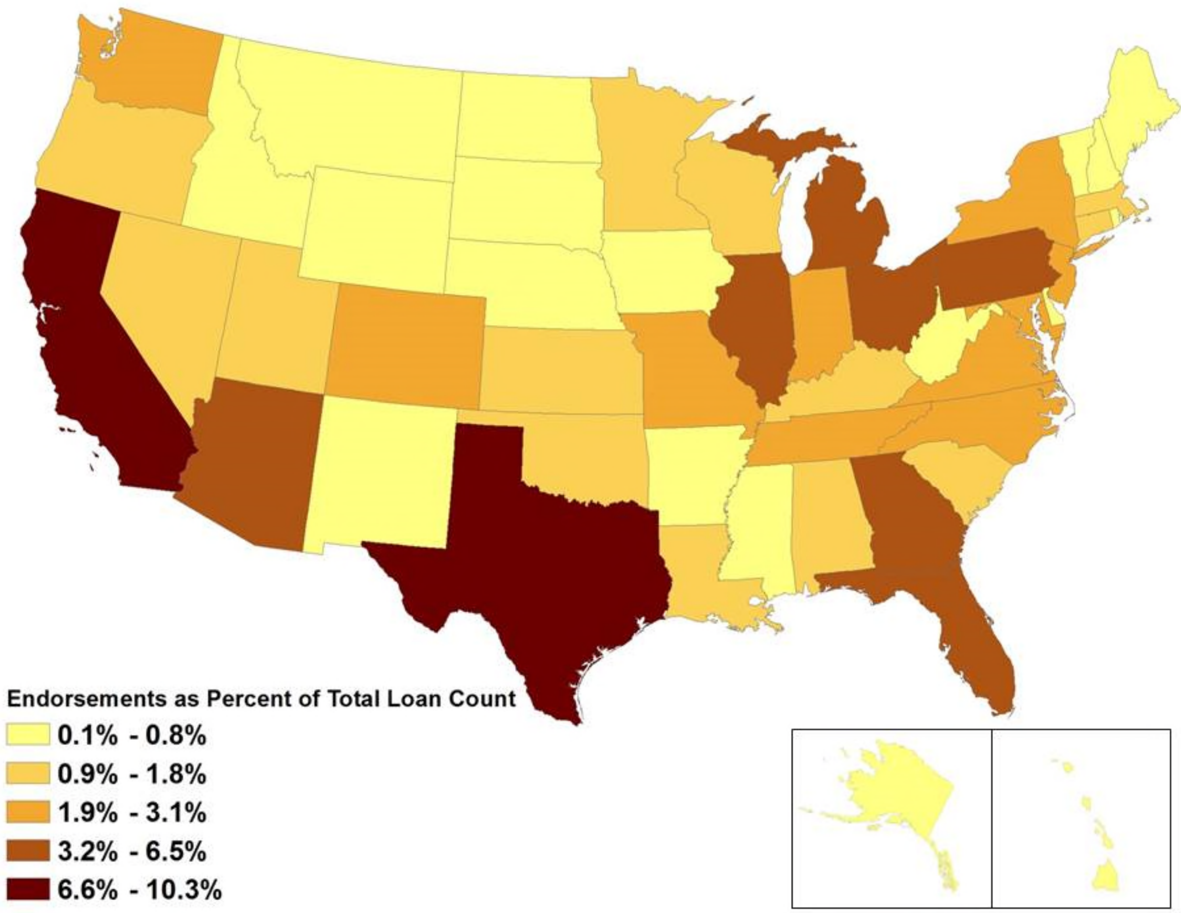
SOURCE: U.S. Department of HUD/FHA, October 2014.

2. Geographic Distribution

Exhibit I-5 shows FHA single-family new Forward endorsements in FY 2014 by property and state. California, Texas, and Florida accounted for 27 percent of all endorsement activity in FY 2014. While this distribution of activity is not surprising, California's share has been subject to large swings. In 2000, FHA insured 93,338 home-purchase loans in California. At the height of the housing boom in 2006, that number had dropped to just 2,316. Then, as conventional mortgage credit tightened during the recession, FHA's activity in California surpassed previous peak levels, with a high point of 135,643 homebuyers served in 2009. In 2014, with conventional sources of credit more readily available once again, FHA insured 63,851 home purchase mortgages in California.

FHA provided the opportunity to refinance 191,315 loans in FY 2014. This represented a 70 percent drop in refinances from 2013 (642,438 loans were refinanced in 2013). Nearly one-third of all refinance activity in FY 2014 again came from states with large populations, including California, Florida, Texas, Ohio and Georgia. Refinance activity in California at 14,595 represented 7.6 percent of all refinances, while refinances in Ohio at 11,061 were 5.8 percent of all refinances.

Exhibit I-5
FHA New Endorsement Activity by State in FY2014



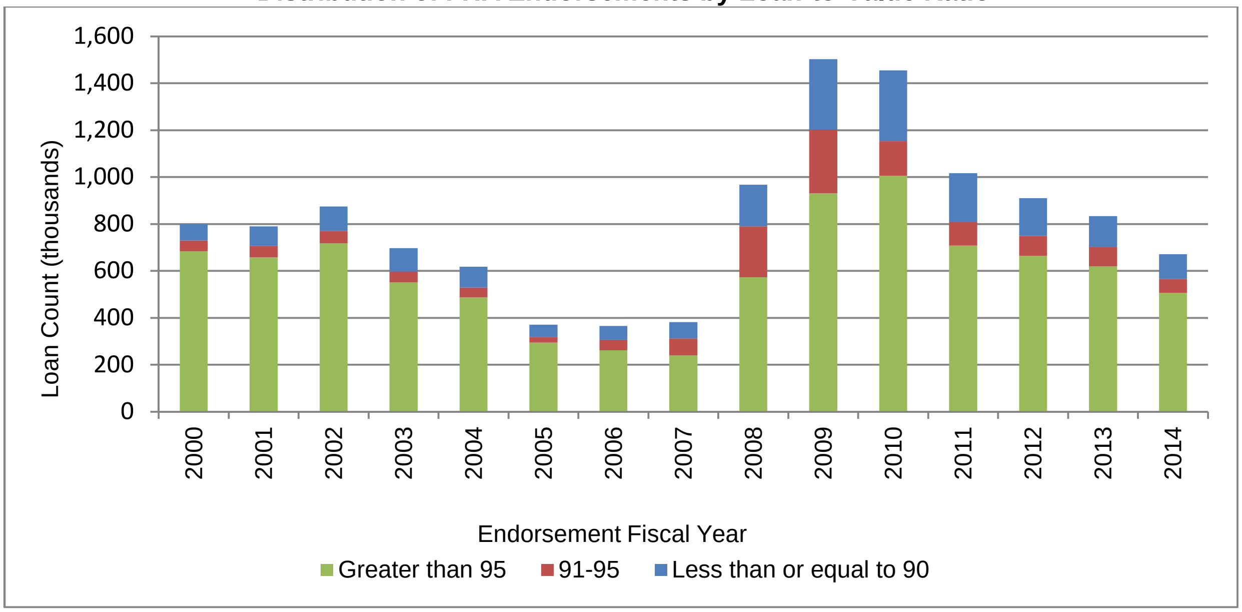
SOURCE: U.S. Department of HUD/FHA, October 2014.

3. Borrower and Loan Characteristics

At 94 percent, the average loan-to-value (LTV) for FHA-insured loans endorsed in FY 2014 remained relatively close to the average LTV of loans insured in FY 2013. The average LTV for home purchase loans, which formed approximately 75 percent of all endorsements, was 96 percent. It is important to note that first-time homebuyers, who are responsible for 81 percent of all purchase loans, drive the high LTV ratios among purchase loans. Among FHA-to-FHA refinance loans, the average LTV decreased from 87 percent to 84 percent. The average LTV ratio for conventional-to-FHA refinances was approximately 82 percent.

Exhibit I-6 shows the distribution of LTV ratios for new FHA endorsements. The share of FHA borrowers with LTV ratios above 95 percent increased slightly this year, continuing a trend that began in FY 2008. In FY 2014, approximately 75 percent of FHA borrowers had LTV ratios above 95 percent. The number of FHA borrowers with LTV ratios below 90 percent continued to decline from the previous year. The current share corresponds to levels consistent with the 2004-2006 period, which reflected FHA's traditional market share.

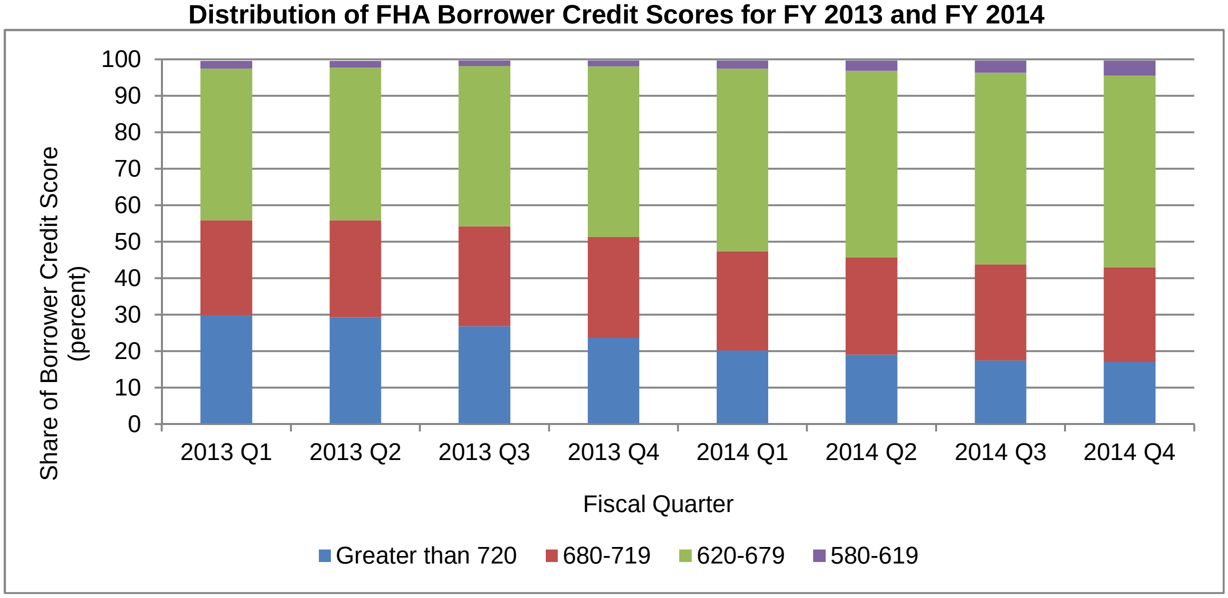
Exhibit I-6
Distribution of FHA Endorsements by Loan-to-Value Ratio



SOURCE: U.S. Department of HUD/FHA, October 2014.

The average credit score of FHA borrowers declined from 693 in FY 2013 to 680 in FY 2014. FHA endorsements for borrowers with credit scores above 720 at the beginning of FY 2013 were close to 30 percent compared to 17 percent at the end of FY 2014. Similarly, borrowers with credit scores between 620 and 679 were 42 percent of endorsements at the beginning of FY 2013 and 53 percent at the end of FY 2014. Endorsements for borrowers with scores less than 620 continued to be a small share in FY 2014 (less than 5 percent), although it has increased during FY 2014 from less than 3 percent at the start of the period (Exhibit I-7).

Exhibit I-7
Distribution of FHA Borrower Credit Scores for FY 2013 and FY 2014



NOTE: Data excludes Streamline Refinances.
SOURCE: U.S. Department of HUD/FHA, October 2014.

The distribution of FHA borrowers by credit score range is shown in Exhibit I-8. Over the past three years, FHA has endorsed a smaller proportion of loans with credit scores greater than 720 while increasing endorsements in the 620-679 range.

Exhibit I-8
Distribution of FHA Borrower Credit Scores by Fiscal Year and Quarter
(Shares in Rows Add to 100%)

Fiscal Year	Quarter	Greater than 720	680-719	620-679	580-619	Less than 579	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

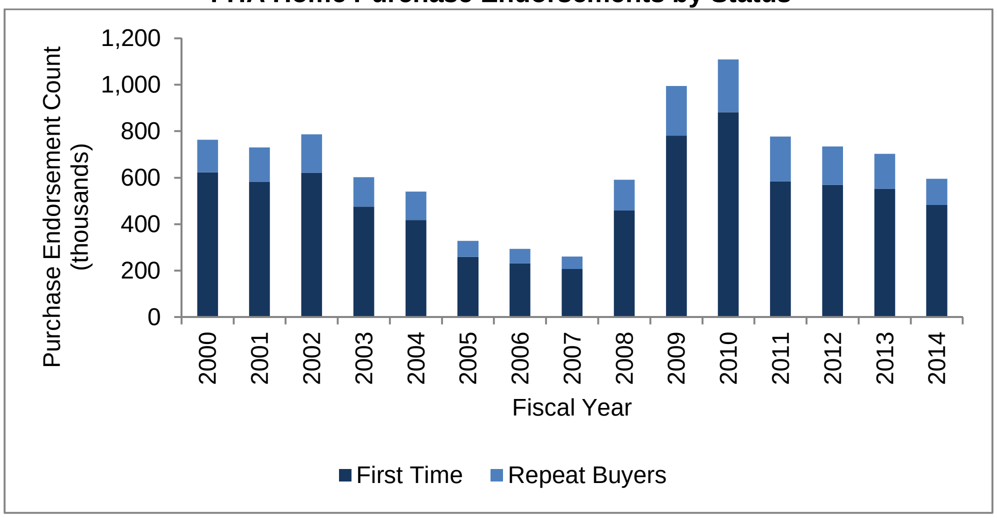
NOTE: Shares are based on loan counts. Data excludes Streamline Refinances.
SOURCE: U.S. Department of HUD/FHA, October 2014.

4. First-time Homebuyers

FHA performs a critical mission driven role in ensuring access to homeownership for households not adequately served by the conventional market. In the last five years alone, FHA has enabled more than 3 million families to become homeowners.

Exhibit I-9 shows the share of first-time homebuyers among FHA home purchase loans since 2000. In FY 2014, loans to first-time homebuyers were 81 percent of all home purchase loans, up slightly from FY 2013.

Exhibit I-9
FHA Home Purchase Endorsements by Status



SOURCE: U.S. Department of HUD/FHA, October 2014.

5. Minority Share

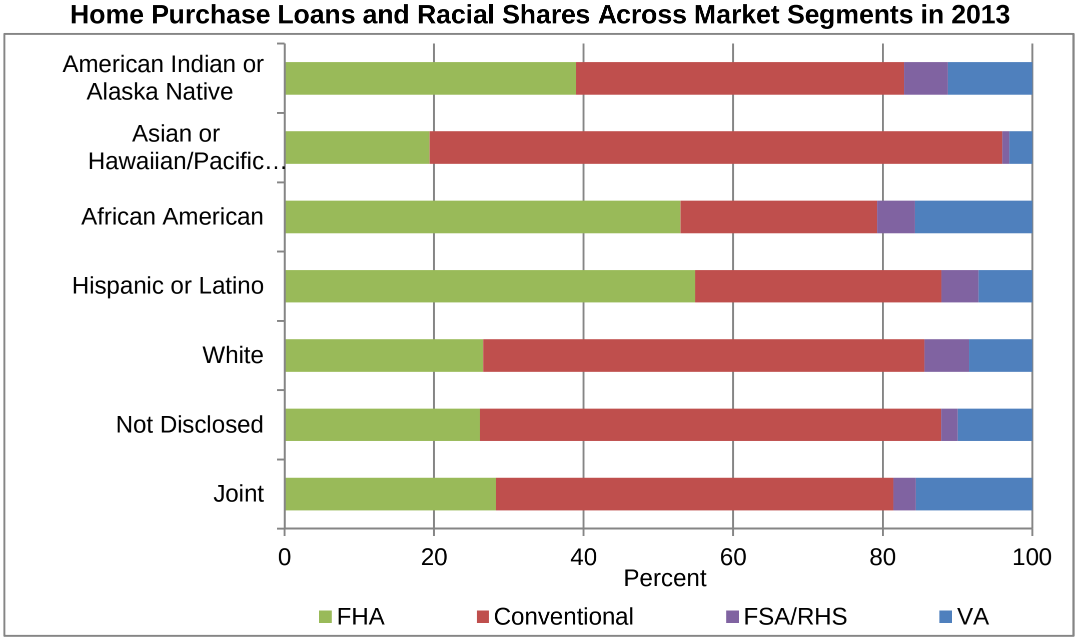
FHA continues to play a crucial role in supporting minority homeownership. According to 2013 Home Mortgage Disclosure Act (HMDA) data, while FHA insurance was used for approximately 23 percent of all home purchase loans, FHA accounted for 46.3 percent of home purchases by African American households and 47.9 percent of purchases by Hispanic households (Exhibits I-10 and I-11).

Exhibit I-10
Home Purchase Loans and Racial Shares Across Market Segments in 2013[a]

		2013 Market Segments (Shares in Rows Add to 100%)			
Race or Ethnicity	Number of Loans	Conventional	FHA	FSA/RHS[b]	VA
All Borrowers	2,748,237	62.9	23.4	4.8	9.0
American Indian or Alaska Native	9,262	47.5	34.5	5.9	12.1
Asian or Hawaiian/Pacific Islander	158,741	82.4	13.7	0.8	3.1
Black or African American	130,534	32.4	46.3	4.5	16.8
Hispanic or Latino	220,070	39.7	47.9	4.6	7.7
White	1,949,002	65.4	20.4	5.5	8.7
Not Disclosed[c]	200,846	69.5	18.8	1.8	10.0
Joint[d]	79,782	59.9	22.1	2.7	15.4

[a]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.
[b]Farm Service Agency and Rural Housing Service
[c]Includes Missing and Not Applicable.
[d]Joint Race definition applies when one applicant reports a single racial designation of White and the other applicant reports one or more minority racial designation.
SOURCE: U.S. Department of HUD/FHA, October 2014.

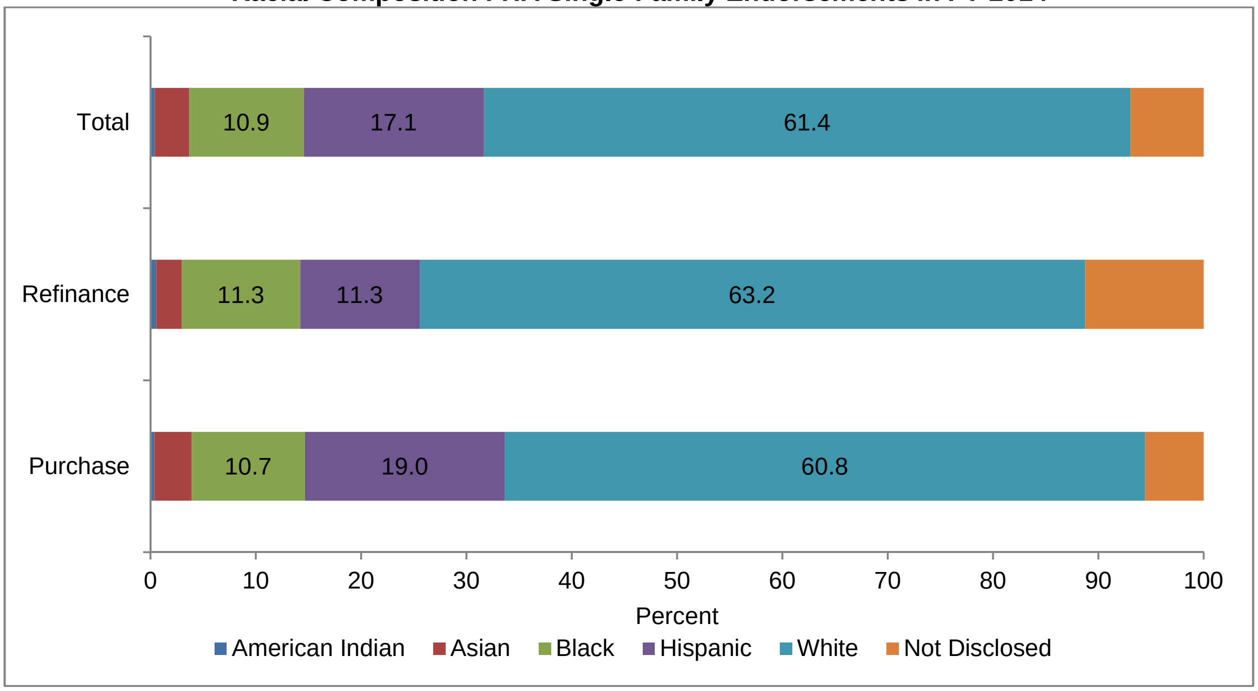
Exhibit I-11
Home Purchase Loans and Racial Shares Across Market Segments in 2013



SOURCE: FFIEC/HMDA Data 2013.

Minority buyers continue to represent nearly one-third of FHA-insured first-time homebuyers in FY 2014. In particular, the share of African American and Hispanic homebuyers increased over the last fiscal year. The total purchase volume for Hispanic homebuyers increased from 16.8 percent to 19.0 percent, and purchase volume for African American homebuyers increased from 9.3 percent to 10.7 percent.

Exhibit I-12
Racial Composition FHA Single-Family Endorsements in FY 2014



SOURCE: U.S. Department of HUD/FHA, October 2014.

B. LOAN PERFORMANCE – FORWARD PORTFOLIO

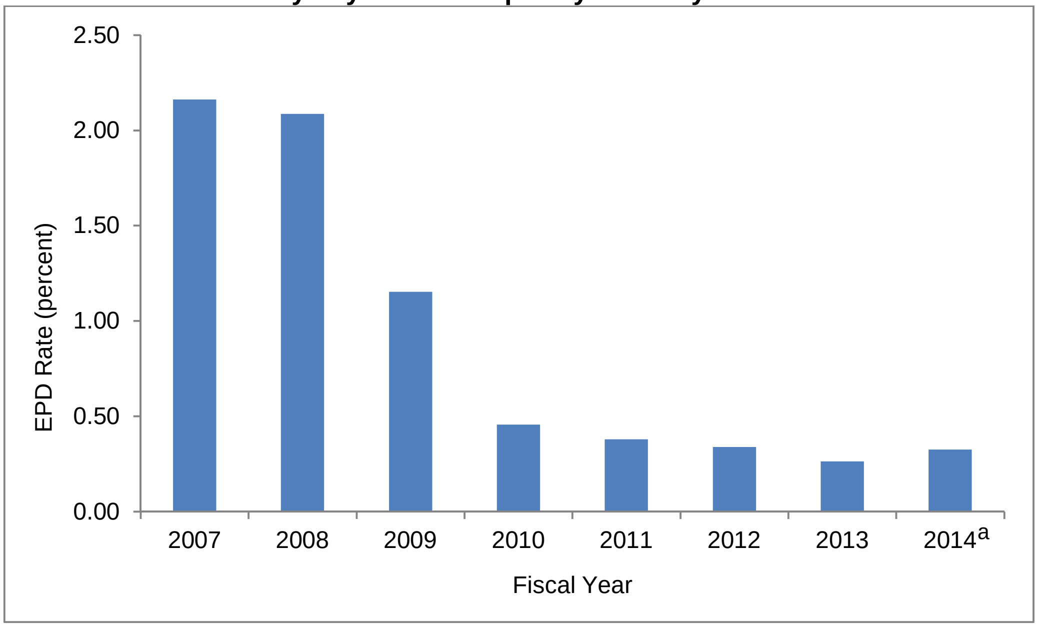
The performance of FHA's portfolio in FY 2014 continued trends seen in recent years, as newer books of business continued to vastly outperform those insured in prior years. Active loans that were endorsed in FY 2006 through the first half of FY 2009 continued to place substantial strain on the MMI Fund while books of business since 2010 show progressively better performance for each origination year.

1. Early Payment Delinquency Rates

After four years of improvement in Early Payment Delinquency (EPD) rates, the first five months of FY 2014 showed an EPD increase. EPD rates provide the first indication of potential credit performance of newly insured loans. The EPD rate is a leading indicator of the long-term claim risk of a particular book of business, relative to other cohorts.

Exhibit I-13 shows EPD rates by cohort, from FY 2007 through February 2014. Rates for the FY 2011 through February 2014 cohorts are less than twenty percent the EPD rates for the FY 2007 and 2008 vintages.

Exhibit I-13
Early Payment Delinquency Rates by Cohort



NOTE: Early payment delinquency is defined as a 90-day delinquency in the first 6 months of a loan's life.
[a]FY 2014 includes endorsements from October 2013 to February 2014.
SOURCE: U.S. Department of HUD/FHA, October 2014.

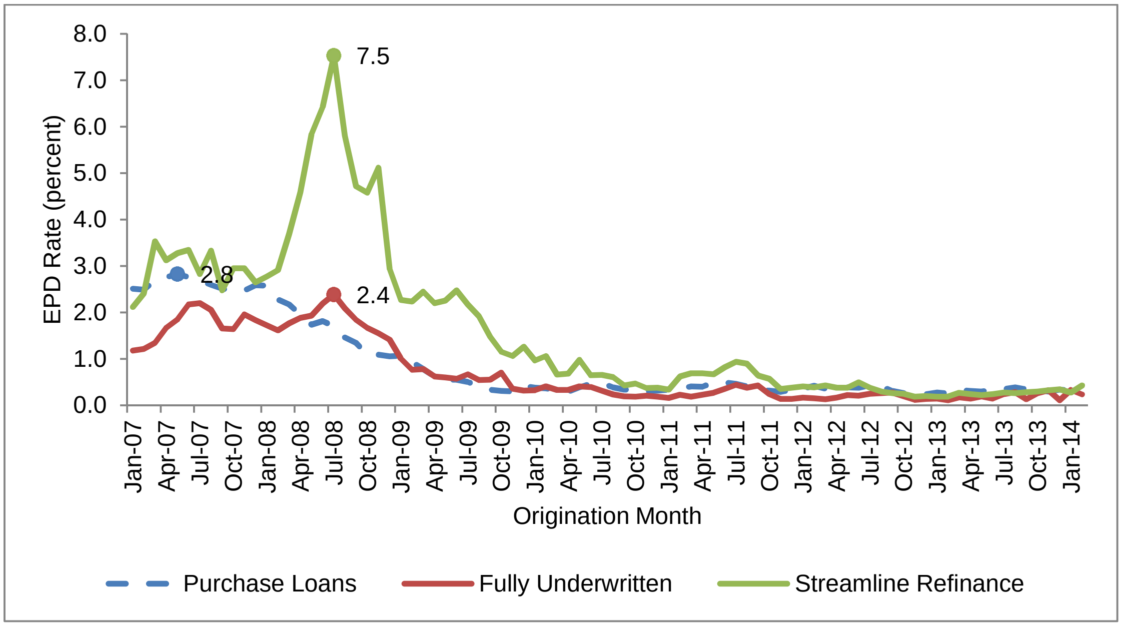
Exhibit I-14 shows the decline in EPD rates by loan purpose, comparing home purchase, streamline refinance, and other types of (fully underwritten) refinance loans. Streamline refinance originations in 2008, and even in 2009, showed higher early payment delinquency rates. FHA believes that this was due to improper use of streamline refinance actions for borrowers with financial difficulties, where in many cases there was no long-term benefit to the borrower in terms of lower monthly payments.

To address this concern, FHA issued new guidance for streamline refinance actions in February 2011, requiring that a net-tangible benefit test be applied before a refinance could be approved. Streamline refinance loans are now performing close to other types of loans.[2]

Today, EPD rates across loan-purpose categories are very similar. Loans originated in the first quarter of FY 2014 had an average EPD rate of 0.31 percent, which is one-seventh the rate recorded for loans originated in the first quarter of FY 2008.

[2] Mortgagee Letter 2011-11

Exhibit I-14
Early Payment Delinquency (EPD) Rates by
Loan Purpose and Origination Month



SOURCE: U.S. Department of HUD/FHA, October 2014.

2. Portfolio Delinquency Rates

Exhibit I-15 shows monthly delinquency rates from September 2013 through the end of FY 2014. The past-due rate, which is the share of loans that are either delinquent, in foreclosure or in bankruptcy, for FHA loans continued to decline in FY 2014, albeit at a slower rate than in FY 2013. In FY 2013 the decline was more than two percentage points to 14.2 percent, whereas the decline in FY 2014 was 1.2 percentage points to 13 percent (Exhibit I-15).

The serious delinquency rate, an indicator of future claim costs, is down 1.1 percentage points from its level at the end of FY 2013, as it has declined from 8.2 percent to 7.1 percent through the end of FY 2014 (seasonally adjusted).

Exhibit I-15
FHA Single-Family Delinquency Rates by Month
(Seasonally Adjusted End-of-month Loan Status)

Month	Active Insurance in Force (EOM)	Delinquency Rates[a] (percent)			Exceptions[b] (percent)		Serious Delinquency Rate[c] (percent)
		30 -day	60 -day	90 -day	In Foreclosure	In Bankruptcy	
Sep 2013	7,810,422	4.4	1.6	4.6	2.5	1.2	8.2
Oct	7,824,151	4.7	1.7	4.6	2.3	1.1	8.0
Nov	7,822,505	4.7	1.7	4.4	2.3	1.1	7.7
Dec	7,818,596	4.6	1.7	4.3	2.2	1.1	7.6
Jan 2014	7,822,609	4.4	1.6	4.1	2.2	1.1	7.3
Feb	7,821,027	4.5	1.7	4.1	2.2	1.1	7.4
Mar	7,812,937	4.3	1.7	4.2	2.2	1.1	7.5
Apr	7,809,896	4.3	1.7	4.4	2.1	1.0	7.4
May	7,806,677	4.3	1.6	4.4	2.1	1.0	7.5
Jun	7,799,793	4.4	1.6	4.2	2.3	1.0	7.5
Jul	7,787,937	4.6	1.6	3.9	2.3	1.1	7.3
Aug	7,784,625	4.6	1.7	4.0	2.2	1.0	7.3
Sept	7,787,092	4.3	1.6	4.0	2.1	1.0	7.1

EOM=end of month.
[a]The 90-day category includes all loans that are at least 3 months delinquent excluding those loans in-foreclosure or in-bankruptcy processing. Included in the delinquency counts are loans under active consideration for loss mitigation foreclosure avoidance.
[b]Exceptions are counted separately from delinquencies, regardless of the length of the delinquency period.
[c]Serious delinquency rates are the sum of 90-day delinquencies, plus in-foreclosures and in-bankruptcies.
SOURCE: U.S. Department of HUD/FHA, October 2014.

Exhibits I-16 and I-17 show serious delinquency rates by cohort, and provide further evidence of the improving quality of more recent loan endorsements. Both exhibits show the FY 2009 cohort in two parts, representing the first and second halves of the fiscal year. This highlights the dramatic changes that took place in FHA loan originations throughout FY 2009, as the credit quality of borrowers improved monthly, and interest rates started their three year decline in December 2008. A decline in market interest rates led to large volumes of refinanced loans. This, coupled with the elimination of seller-funded down payment assistance loans, substantially improved the performance of loans endorsed in the second half of FY 2009.

At the end of their first year, the cohorts from FY 2007-2009 had serious delinquency rates more than four times those of the FY 2010-2013 cohorts at the same point of seasoning. The cohort endorsed in FY 2013 has performed the best with a 0.9 percent serious delinquency rate (Exhibit I-16). The FY 2007 and 2008 cohorts have had the worst serious delinquency rates as they have seasoned, although in the latest year of seasoning serious delinquency rates have improved slightly. This can be observed for FY 2006 and the first half of FY 2009 as well.

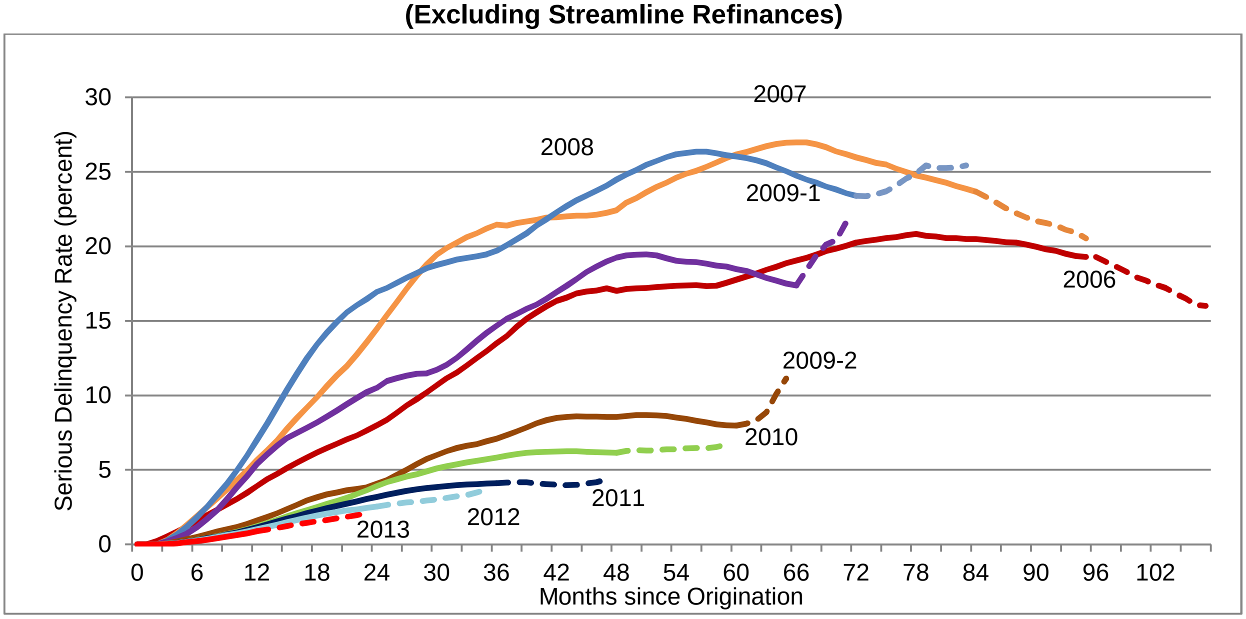
Exhibit I-16
Serious Delinquency Rates by Loan Origination Year at Various Stages of Seasoning (Excluding Streamline Refinances)

Age (years)	Fiscal Year of Origination (percent)								
	2013	2012	2011	2010	2009-2	2009-1	2008	2007	2006
1	0.9	1.0	1.2	1.2	1.6	5.4	7.0	5.7	3.5
2		2.5	3.2	3.9	4.1	10.5	17.0	14.5	7.7
3			4.1	5.8	7.1	14.7	19.7	21.5	13.0
4				6.2	8.6	19.3	24.5	22.4	17.2
5						18.5	26.0	26.2	17.5
6							23.4	26.0	20.0
7								23.7	20.5
8									19.3

SOURCE: U.S. Department of HUD/FHA, October 2014.

Exhibit I-17 provides a graphical representation of the development of serious delinquency rates throughout this recent economic cycle for cohorts FY 2006-2013. This view highlights again how loans endorsed in the first half of 2009 are performing more like earlier vintages endorsed near the peak of the housing cycle. Cohorts for the second half of FY 2009 through FY 2013 show consistent improvement through each year of seasoning and continue to compare favorably with FY 2006 through the first half of FY 2009. The portion of each curve that is subject to future changes is shown by the dashed portion of each curve, which corresponds to the most recent 12 months of data. For the FY 2008 and 2009 cohorts, in particular, there can be significant positive revisions because the quality of each book has continuously improved each month.

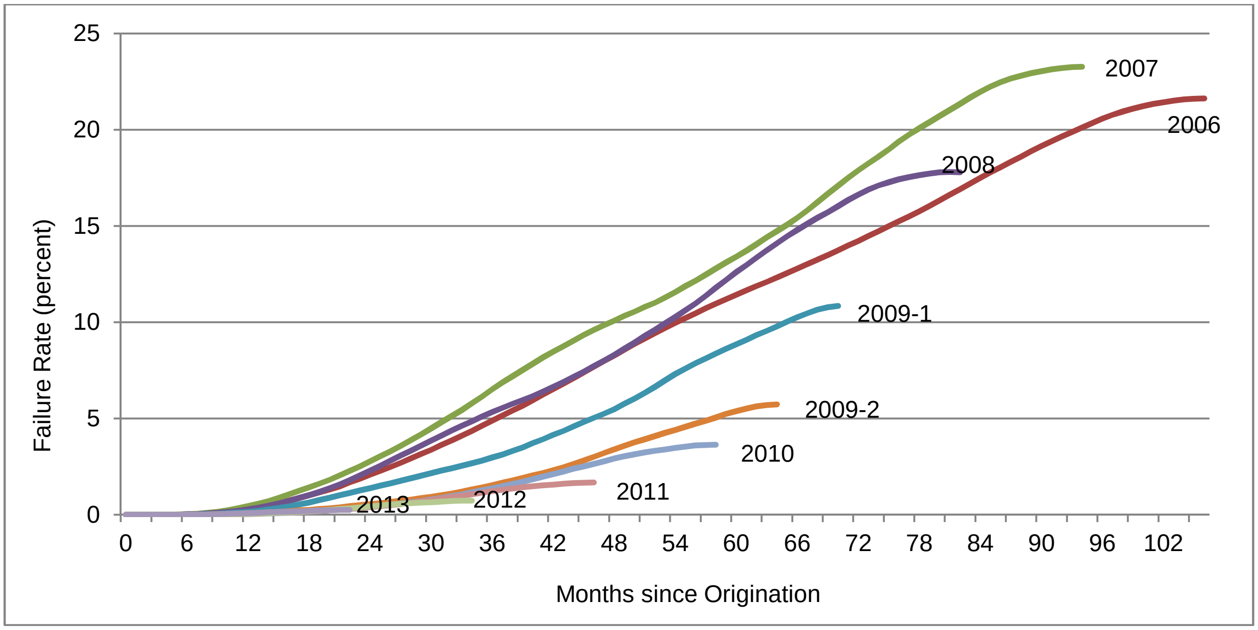
Exhibit I-17
Serious Delinquency Rates by Origination Cohort (Excluding Streamline Refinances)



SOURCE: U.S. Department of HUD/FHA, October 2014

Exhibit I-18 shows "failure rates"[3] of FHA loans by cohort. The 2013 vintage continues the trend of year over year improvements in the failure rate. (Note: 2014 cohorts have not yet seasoned long enough for meaningful data to be captured.)

Exhibit I-18
Failure Rates by Seasoning and Vintage
(Excluding Streamline Refinances)



NOTE: A failure rate is the sum of to-date claims and active foreclosures, as a percentage of initial endorsements for each cohort.
SOURCE: U.S. Department of HUD/FHA, October 2014

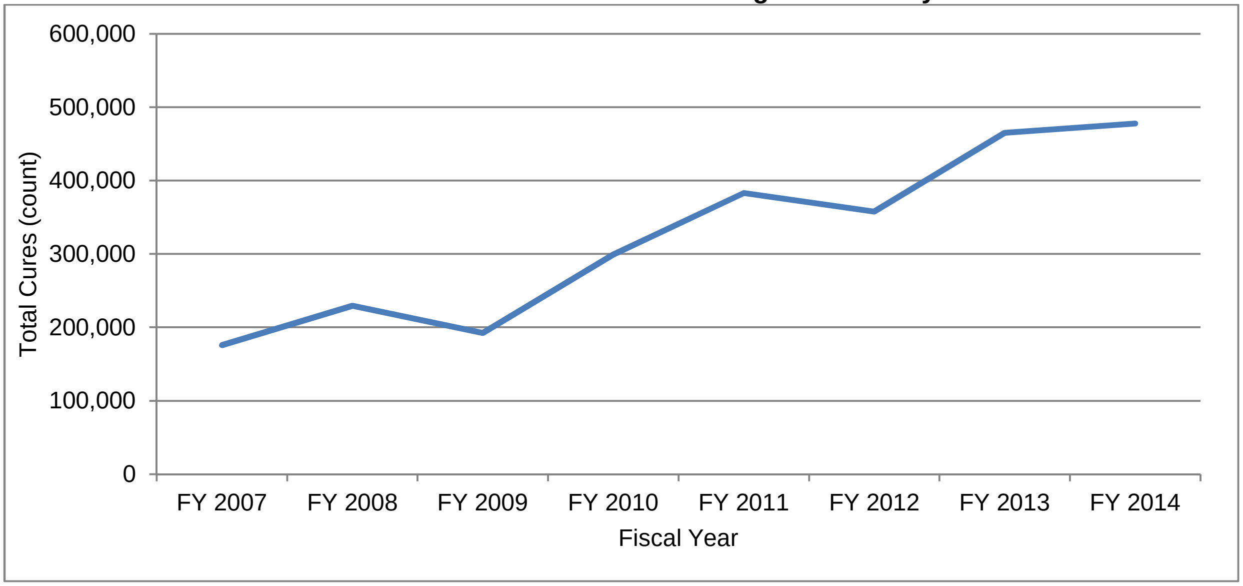
3. Controlling Claim Costs

FHA has launched a number of major initiatives to minimize and control claim costs, which have already demonstrated clear results. These include changes to home retention and loss mitigation activities and new approaches to claim resolution and asset disposition.

a) **Home Retention and Loss Mitigation.** FY 2014 cures[4] increased slightly to 477,579 over the course of the year compared to FY 2013; an increase of 2.7 percent. (Exhibit I-19.)

[3] A failure rate is defined here as the sum of to-date claims and active foreclosures, as a percentage of initial endorsements for each cohort.
[4] A cure is defined as making a payment, either in full or in part, on a mortgage that is in default.

Exhibit I-19
FHA Home Retention and Loss Mitigation Activity



SOURCE: U.S. Department of HUD/FHA, October 2014.

Exhibit I-20 shows cures by type of loss mitigation assistance. It is important to note that, as of May 2013, Promise to Pay is no longer classified as a repayment plan and is instead considered its own category. In FY 2013 Repayment Plans were 292,000 and in FY 2014 Repayment Plans and Promise to Pay were about 294,000, of which approximately 170,000 were Repayment Plans.

The next highest loss mitigation assistance shown in Exhibit I-20 was FHA HAMP at 141,000 or 30 percent of all loss mitigation assistance. This program is a major focus in the revised FHA loss mitigation waterfall for FY 2014. When the FHA HAMP option first became available in 2010, it represented less than one percent of all assisted cures. In FY 2014 it represented a more than two-fold increase over the prior fiscal year. The increase in FHA HAMP has been accompanied by a large decrease in traditional FHA loan modifications, down from 21 percent in FY 2013 to less than 3 percent in FY 2014.

Partial Claims represented a 102 percent increase over FY 2013. The increased use of Partial Claims and its share in 2014 may represent improved employment conditions in many areas of the country. The Partial Claim option is most beneficial for borrowers with limited incomes, but whose monthly – and surplus – incomes have returned to their pre-default levels.

FHA expects the FHA HAMP option to continue to play an important role in the future, as new delinquency servicing guidelines established in 2013 require loan servicers to target assistance toward ensuring borrowers have affordable mortgage payments. This will lead to more FHA HAMP actions—each of which includes a principal deferment element—as interest rates rise and rate-and-term modifications become less valuable in lowering monthly payment burdens.

Exhibit I-20
Number of Assisted Delinquency Cures by Type and Fiscal Year of Cure

FY of Assisted Cure	Repayment Plans	Loan Modi-fications	Partial Claims	FHA HAMP	Promise to Pay	Total Assisted Cures
	Type of Loss Mitigation Assistance					
	Shares by Assistance Type within each Fiscal Year (percent)					
2007	70.4	25.1	4.5			175,612
2008	71.8	25.9	2.3			229,354
2009	57.6	37.8	4.6			192,232
2010	44.0	51.4	3.8	0.8		299,287
2011	56.3	38.1	3.2	2.4		382,829
2012	70.9	23.1	1.9	4.2		357,639
2013	62.8	21.0	3.1	12.9	0.3	464,828
2014	35.6	2.6	6.2	29.6	26.0	477,579

SOURCE: U.S. Department of HUD/FHA, October 2014.

b) New Approaches to Claim Resolution and Asset Disposition. It is not always possible for homeowners who are in default on their mortgages to reestablish the financial capacity to maintain their existing mortgage obligations. The traditional remedy available to FHA was to use the legal foreclosure process to obtain title to the property as satisfaction for the debt, and then to manage and sell that property via the “real-estate owned” (REO) process. REO sales, however, are typically the most expensive disposition method for FHA.

During the course of FY 2014, FHA continued its ongoing efforts to control the net losses that result from what might be termed “full loan default” by pursuing a variety of alternative disposition options. The results of these efforts can be seen in Exhibit I-21. While traditional REO actions are still the largest resolution type, in FY 2014 they no longer represent the majority. The share of REO dispositions dropped from 58 percent in FY 2013 to near 43 percent in FY 2014.

The expansion of these programs, described below, has had a significant impact on overall net loss rates, as is clear in Exhibit I-21. Overall loss rates have continued to improve from 57 percent to 51.5 percent from FY 2013 to FY 2014.

Exhibit I-21
Comparing Default Dispositions in FY 2013 and 2014

	2014			2013		
Disposition Type	Loss Rate (% UPB)	Disposition Counts	Share of Dispositions (%)	Loss Rate (% UPB)	Disposition Counts	Share of Dispositions (%)
REO	59.8	66,600	42.6	62.0	107,200	58.2
Note Sale (DASP)	49.1	40,000	25.6	63.6	33,700	18.3
Third Party Sales	46.1	25,800	16.5	40.9	10,300	5.6
Pre-Foreclosure Sales	44.3	23,900	15.3	43.8	33,200	18.0
Total	51.5	156,300	100.0	57.1	184,300	100.0

UPB = unpaid principal balance.
NOTE: Counts are rounded to nearest hundred.
SOURCE: U.S. Department of HUD/FHA, October 2014.

- **Distressed Asset Stabilization Program (DASP).** Throughout FY 2014, FHA conducted a series of bulk note sales of seriously delinquent FHA-insured loans under DASP. Through DASP, FHA sells non-performing mortgages to investors prior to the completion of a foreclosure, potentially providing alternatives to foreclosure for borrowers and enabling FHA to avoid costs associated with managing and marketing the underlying collateral as REO properties. Throughout FY 2014, FHA paid approximately 40,000 insurance claims in connection with its DASP sales. The number of DASP dispositions increased as a share of total dispositions from 18 percent in FY 2013 to 26 percent in FY 2014, and more importantly, the loss rate decreased significantly from 64 percent to 49 percent.

Exhibit I-22
Foreclosure Starts

SOURCE: U.S. Department of HUD/FHA, October 2014.

Foreclosure rates have continued to decline since FY 2012 (Exhibit I-22), and DASP has been critical for clearing a backlog of distressed assets.

- **Third-Party Sales (TPS)**. The second major area of REO alternatives in FY 2014 was the continued expansion of what had been a pilot program to encourage sales of foreclosed properties to third-parties at foreclosure auctions. Such sales allow FHA to avoid the costs associated with taking possession of properties and selling them as REO. In FY 2014, the share of TPS increased from 6 percent to 16 percent. The loss rate increased slightly from 41 percent to 46 percent; however this remains substantially lower than the REO loss rate of 60 percent. FHA-authorized servicers continued to use bidding instructions which align with FHA's expected recoveries in REO. Many TPS bids were high enough that no claim was filed with FHA for shortage of sale proceeds against the total indebtedness. FY 2014 has experienced the greatest increase in non-claim TPS bids since the program's inception with 2,649 bids. This was a 35 percent increase from 1,969 non-claim bids in FY 2013.

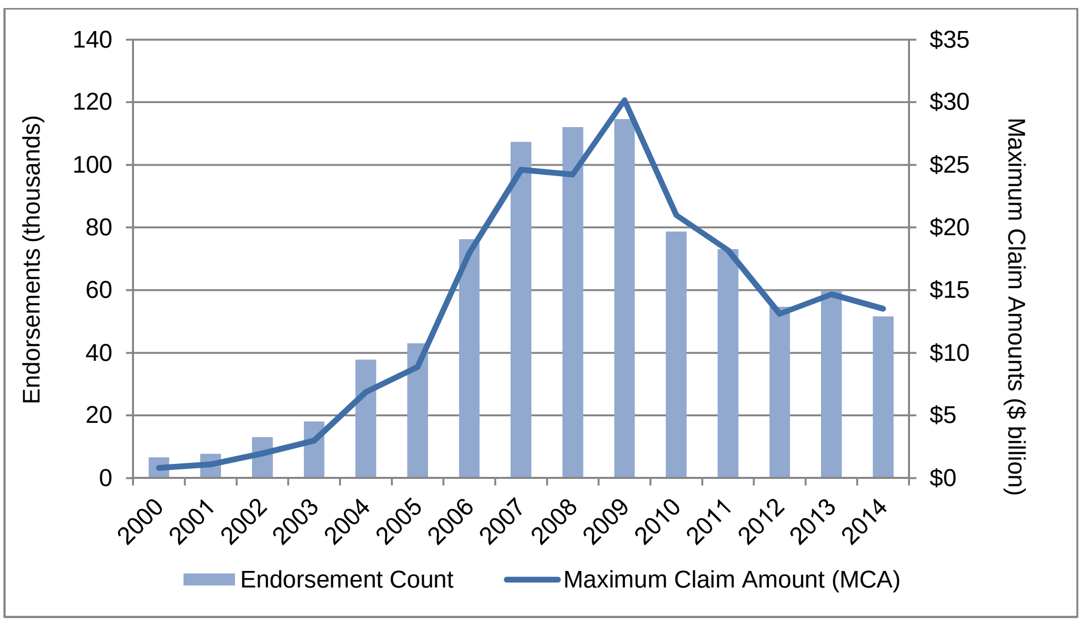
- **Pre-foreclosure Sales (PFS).** Consistent with FHA's expectations for the trend in PFS, in FY 2014 PFS decreased slightly from 18 percent to 15 percent. The increase in other disposition programs such as bulk note sales and TPS will continue to impact loans that resolve as PFS.

C. REVERSE MORTGAGES – HOME EQUITY CONVERSION MORTGAGE (HECM)

FHA assisted more than 51,000 senior homeowners to age in place during FY 2014 through the Home Equity Conversion Mortgage (HECM) program. HECM enables owners 62 years of age and older to access accumulated home equity for a wide variety of financial needs. HECM loans accrue interest on outstanding balances, but there are no monthly payment requirements, and loans are not due-and-payable until the borrower exits the home or other reasons of default occur. Many senior citizens use HECM loans to pay off outstanding home mortgages, substantially reducing their monthly housing expenses and creating the financial margin needed to stay in their home on a reduced income.

FHA measures dollar volumes of HECM loan guarantees by the maximum claim (payout) amount (MCA). The MCA is the lesser of the property appraised value, sales price or FHA loan limit applicable at the time of loan origination. In FY 2014, FHA guaranteed $13.5 billion in HECM loans. This represents an eight percent decline over FY 2013. This decline reflects FHA program changes such as lowering principal limit factors, changes to upfront MIP pricing and limits on the types of Fixed Interest Rate mortgages that can be insured through HECM. The average age of new borrowers in 2014 was 71 years. Single males made up 21 percent of borrowers, single females accounted for 39 percent, and married couples constituted the remaining 40 percent.

Exhibit I-23
HECM Endorsement Counts and Maximum Claim Amounts



SOURCE: U.S. Department of HUD/FHA, October 2014.

FHA continued its efforts to improve the actuarial soundness of the HECM program and made substantive changes that were implemented in FY2014.

- **Standard and Saver Product Structure Elimination.** In 2010, FHA introduced the "Saver" alternative to the Standard HECM product. The HECM Saver program charged a lower upfront mortgage insurance premium (MIP) but also reduced the amount of housing equity a borrower can access. Thus, the Saver's upfront mortgage insurance premium of one basis point attracted borrowers who can accept less funds in order to pay a lower mortgage insurance premium than the two percent premium charged by the Standard HECM program.

  Starting at the beginning of FY 2014, the existing Standard and Saver programs were replaced by a more conservative program to improve the financial viability of the HECM program. The program has lower principal limit factors than the Standard program, in addition to initial disbursement limitations and the introduction of a single disbursement lump sum payment option. Furthermore, the initial MIP is based on the mortgagor's initial disbursement[5] (Exhibit I-24).

  FHA introduced new limits to the amount of principal a borrower would be able to draw within the first twelve-month disbursement period in order to counter the evolving industry practice of encouraging mortgagors to make large initial draws on fixed interest rate HECMs, which resulted in less hedging risk for mortgagees on fixed rate loans. FHA also introduced the Single Disbursement Lump Sum payment option, which provides an option to mortgagees to limit hedging risk by effectively eliminating future draws on Fixed Rate HECMs. The MMI Fund benefited from the resulting shift to smaller upfront draws, more ARM HECMs and less mortgagee exposure to hedging risks.

- **Limit on Insurability of Fixed Rate HECM Products**[6]. FHA will only insure fixed interest rate reverse mortgages where the mortgage limits the mortgagor to a single, full draw to be made at loan closing, and does not provide for future draws by the mortgagor under any circumstances. FHA will continue to insure adjustable interest rate reverse mortgages where the payment plan option is tenure, term, line of credit, modified tenure, or modified term.

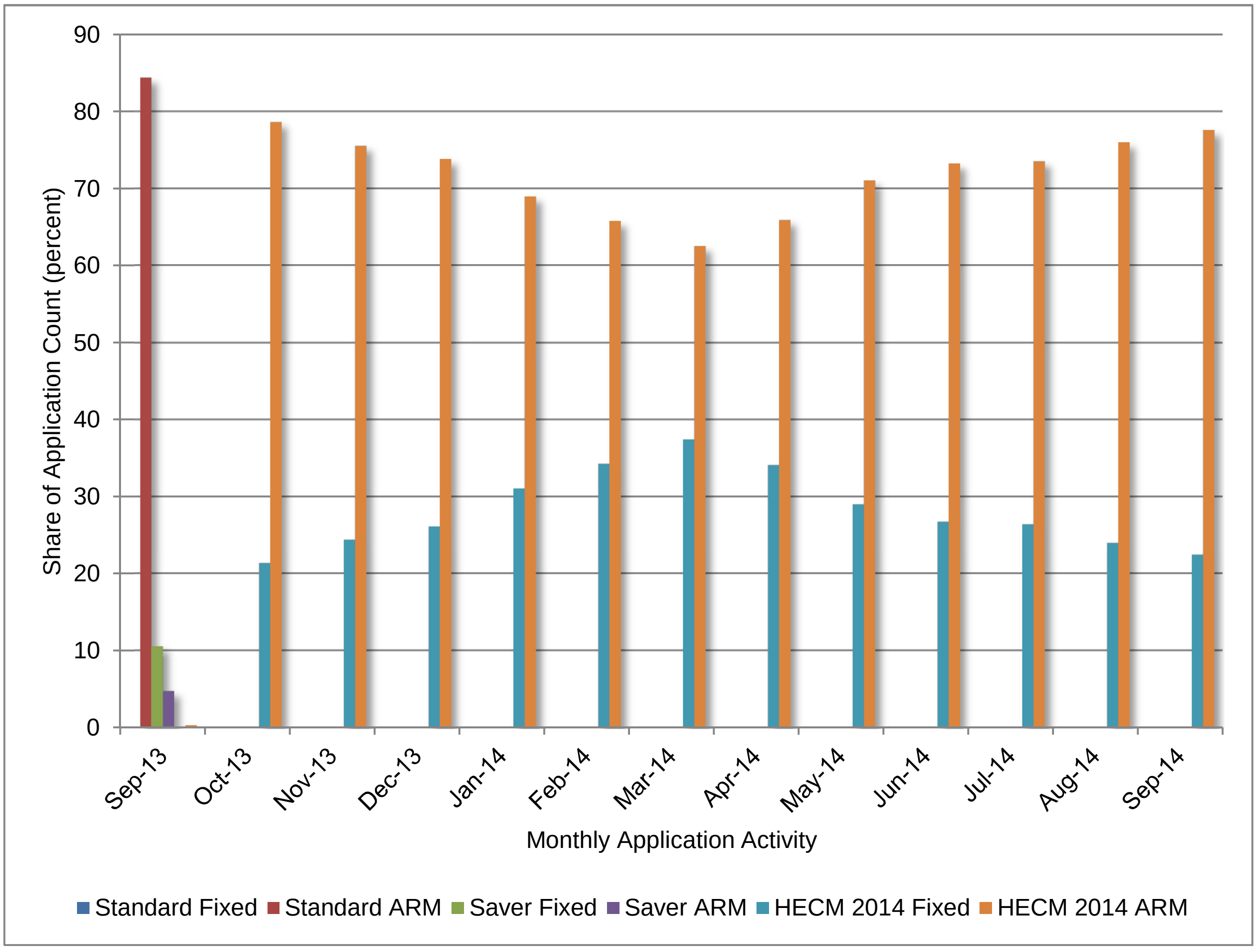
- **Financial Assessment and Property Charge**[7]. To ensure HECM mortgagors can meet their financial obligations and comply with mortgage requirements, such as the payment of property charges, FHA issued guidance that requires mortgagees to perform a financial assessment of prospective mortgagors on all HECM transaction types. This assessment includes performing a credit history analysis, cash flow/residual income analysis, documenting and verifying credit, income, assets and property charges (including determining if funding sources for property charges from HECM proceeds will be required). Based on feedback to the Federal Register Notice posted on this topic, FHA published revised guidance in November 2014 with a delayed effective date of March 2015.

- **HECM Non-Borrowing Spouse**[8]. To provide guidance on how Non-Borrowing Spouses are able to retain their homes upon the death of their mortgagor spouses, FHA published prospective standards for HECM mortgages with case numbers assigned on or after August 4, 2014. This guidance is applicable to both the mortgagor and eligible Non-Borrowing Spouse, including

[5] Mortgagee Letter 2013-27
[6] Mortgagee Letter 2014-11
[7] Mortgagee Letter 2013-28, Mortgagee Letter 2013-27 and Mortgagee Letter 2013-33
[8] Mortgagee Letter 2014-07

common law spouses. This will obviate the need for eligible Non-Borrowing Spouses to refinance or satisfy the HECM loan obligation upon the death of the mortgagor.

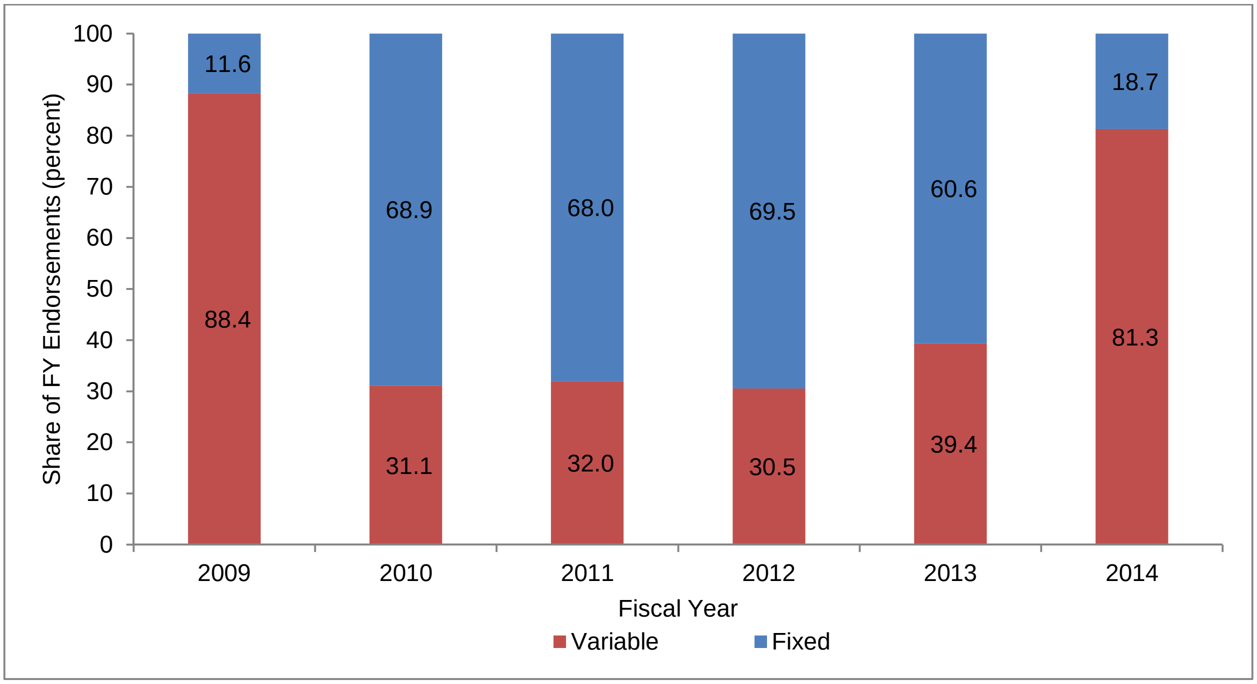
Exhibit I-24
HECM Application Shares by Type



SOURCE: U.S. Department of HUD/FHA, October 2014.

The effect of these efforts, in addition to the elimination of the HECM Saver program, is visible in Exhibit I-25. Variable rate HECM endorsements experienced a sharp rise in FY 2014, from 39 percent in FY 2013 to 81 percent. Fixed-rate products with requirements for initial lump-sum draws historically experienced higher taxes and insurance (T&I) default rates compared to variable rate mortgage. This shift towards variable rate mortgages reduces the risk to the HECM program. In a reversal of trends over the last four years, shares for fixed rate products in FY 2014 were closer to FY 2009 levels.

Exhibit I-25
HECM Endorsement Share by Rate Type

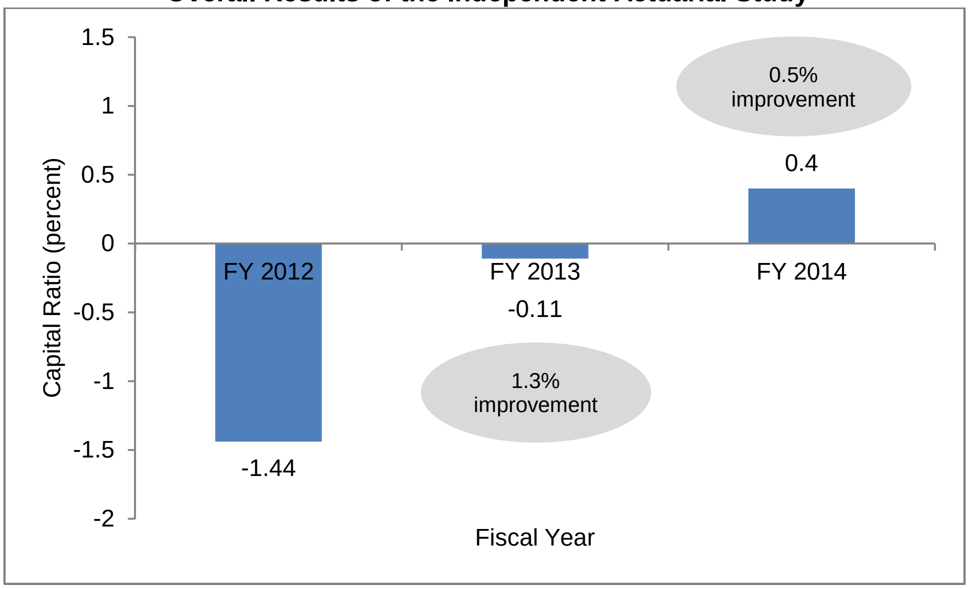


SOURCE: U.S. Department of HUD/FHA, October 2014.

II. Status of the Mutual Mortgage Insurance Fund

The independent actuary reports that the MMI Fund continues the positive momentum started in 2013. This fiscal year, the MMI Fund's Economic Net Worth improved by $6.1 billion from last year's actuarial estimate, increasing from negative $1.3 billion to positive $4.8 billion. The MMI Fund has improved by over $21 billion dollars since 2012. The MMI Fund Capital Ratio similarly improved by 1.85 percent, from *negative* 1.44 percent to positive 0.41 percent over that time period, as shown in Exhibit II-1.

Exhibit II-1
Overall Results of the Independent Actuarial Study



SOURCE: FY 2012, FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

This chapter starts with a summary discussion of the findings of the Independent Actuarial Report, and then provides 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.[9]

A. FINANCIAL STATUS OF THE MMI FUND

The overall value of the Fund is defined as the Economic Net Worth (ENW), as outlined in the National Housing Act, and consists of two elements:

- The current net asset position of the portfolio (net capital resources); and
- The actuary's estimate of the present value of future cash flows on outstanding insurance commitments. This is equal to the actuarial estimate 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

[9] See http://www.hud.gov/offices/hsg/hsgrroom.cfm.

over the life of the loans. Additional detail is available through the final written reports prepared by the independent actuary. The reports are available online in the FHA/Office of Housing Reading Room.

The Capital Reserve Ratio is then calculated by dividing the ENW by the value of the outstanding insured portfolio (the amortized insurance-in-force) at the end of the relevant fiscal year. Exhibit II-2 shows these calculations and changes from last year as well.

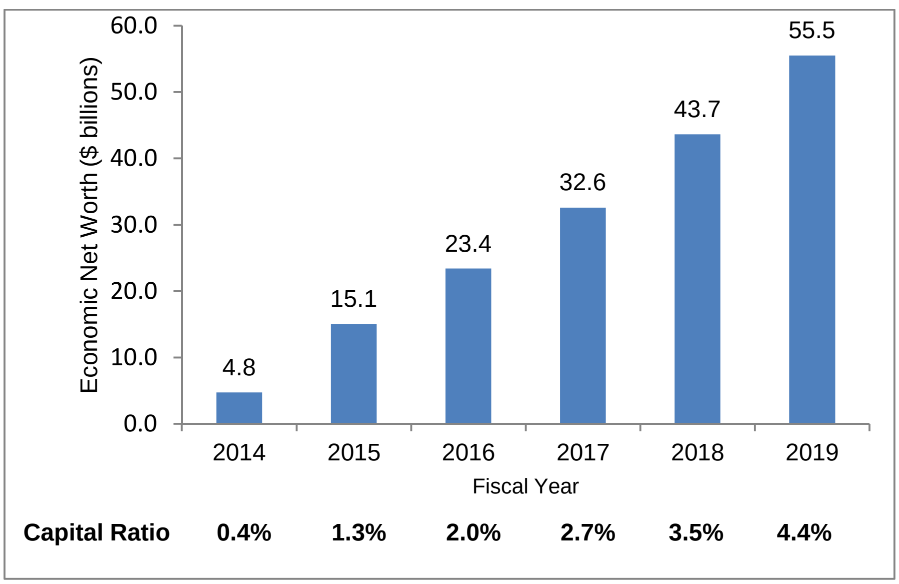
Exhibit II-2
Changes to the Capital Resources and Capital Ratio of the MMI Fund ($ millions)

	FY 2013	FY 2014	Difference
Capital Resources at end of fiscal year	29,680	28,432	-1,248
Plus: Actuary's present value of future cash flows on outstanding insurance	-31,010	-23,667	7,343
Economic Net Worth (ENW)	-1,330	4,765	6,095
Amortized Insurance-in-Force at end of fiscal year (IIF)	1,178,154	1,156,741	-21,413
Capital Ratio (ENW/IIF) (%)	-0.11	0.41	0.52

SOURCE: FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

According to the assessment of the independent actuary, the economic net worth and capital ratio for the MMI Fund is projected to increase over the next five years and is projected to be positive for the remainder of the forecast period. The Fund is expected to achieve 2 percent capital ratio in FY 2016, as shown by Exhibit II-3.

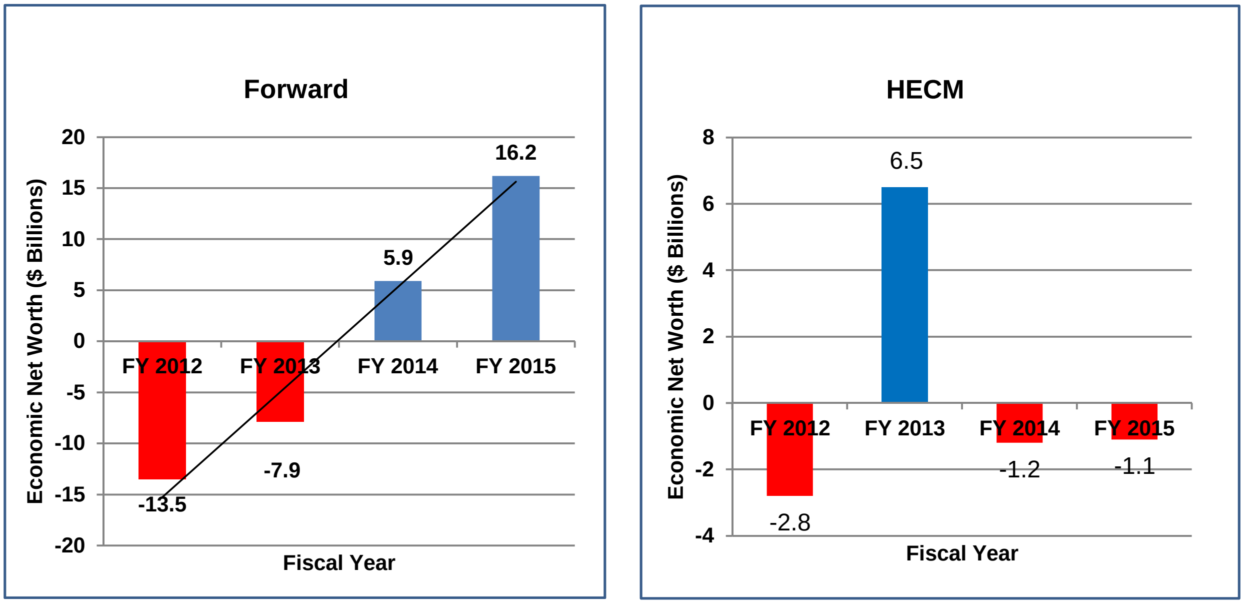
Exhibit II-3
Annual Projection of MMI Fund Economic Net Worth and Capital Ratio
FY 2014 – FY 2019



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

Exhibit II-4 compares momentum of Forwards versus HECM—the two portfolios that make up the MMI Fund. The value of the Forward portfolio has improved by over $19 billion since FY 2012, with a similar increase projected for FY 2015. In contrast, performance of the HECM portfolio has been more erratic, with a negative economic value posted for 2014 and virtually no growth in value projected for FY 2015.

Exhibit II-4
Economic Net Worth Under Base-Case Estimates, 2012–2015



Source: FY 2012, FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

Capital Resources

Capital resources are the net assets of the Fund that, if necessary, could be converted into cash to meet the Fund's obligations, including payment of claims as they arise. They are computed by subtracting total liabilities from total assets. The assets consist of cash, Treasury investments, properties, mortgages, other assets and miscellaneous receivables net of payables. At the end of FY 2014 the MMI Fund had net capital resources of approximately $28.4 billion which compares to $29.7 billion at the end of FY 2013. Exhibit II-5 details how capital resources have changed over the past year.

Exhibit II-5
FY 2014 MMI Fund Capital Resource Balances and Activity ($ millions)

	Forward	HECM	MMI Fund
Capital Resources at Beginning of FY (10/1/13)	20,561	9,119	29,680
Capital Resources at End of FY (9/30/14)	19,616	8,816	28,432
Composition of Capital Resources at End of Fiscal Year 2014			
Cash	31,966	7,995	39,961
Investments	6,323	51	6,374
Properties and Mortgages	3,503	774	4,277
Other Assets and Receivables	1,252	4	1,256
Total Assets	43,044	8,824	51,868
Liabilities	-23,428	-8	-23,436
Capital Resources at End of FY (9/30/14)	19,616	8,816	28,432

SOURCE: U.S. Department of HUD/FHA; HUD Accounting systems, and the FY 2014 Actuarial Reviews of the MMI Fund.

B. SINGLE FAMILY FORWARD PORTFOLIO

1. Economic Net Worth by Book-of-Business

Single Family “Forward” mortgage loans comprise the vast majority of the portfolio of the MMI Fund – accounting for more than 90 percent of insurance-in-force. The value of the Forward portfolio increased almost $14 billion over the past year, compared to an increase of about $6 billion for the overall MMI Fund.

Projected lifetime losses (many of which have already occurred) are particularly large for the fiscal year 2007-2009 loans. Those loan cohorts were impacted by the severe recession and accompanying increases in unemployment, low premium revenue relative to expected losses, and large volumes of loans using seller-funded down payment assistance.

In contrast, the actuary expects endorsements from FY 2010 through FY 2014 to produce significant net revenues that could be used to offset any mounting losses from earlier books of business. Exhibit II-6 demonstrates the contrast in quality between vintage eras.

Exhibit II-6
Lifetime Book Value by Endorsement Vintage (Forward Loans)

Cohort	Endorsement ($ billions)	Book Value ($ billions)	Book Value, Percent of Endorsements
1992 - 2000	660	8.4	1.3
2001 - 2006	586	(12.9)	-2.2
2007 - 2009	559	(26.6)	-4.8
2010 - 2013	962	34.0	3.6
2014	134	11.1	8.3
Total	2,900	14.3	0.5

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

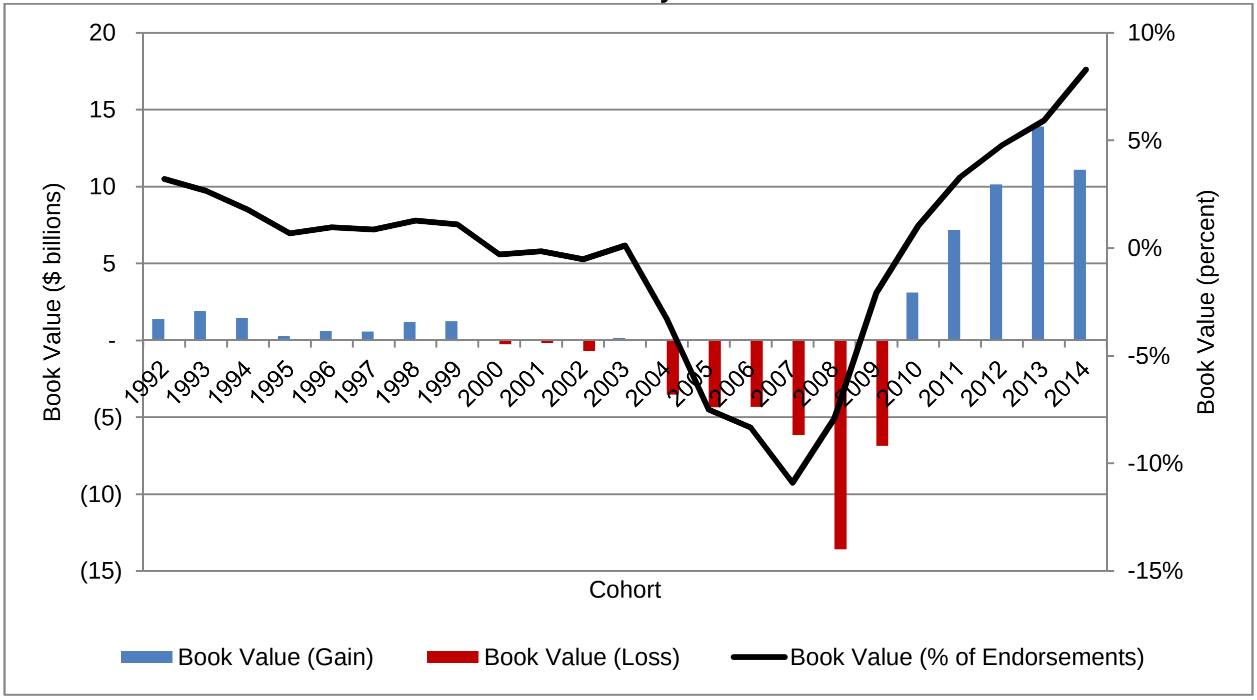
In addition to the impact of the housing downturn, the 2007-2008 books were also heavily affected by loans using seller-funded down-payment-assistance (SFDPA). Those types of loans became ineligible for FHA insurance starting with originations in FY 2009, and they essentially disappear from new endorsements starting in January 2009.[10] However, their ongoing effect on the financial status of the MMI Fund is still measurable, as they are expected to result in 25 percent of the losses for the 2007-2008 vintages.[11] The actuary estimates that economic net worth of the MMI Fund would be higher by over $16 billion without SFDPA loans.[12] Thus, if FHA had not insured any SFDPA loans, the net economic value of the MMI Fund would be positive by more than $21 billion today.

Given the importance of premium revenue as a key tool to balance risk, this Administration has put great emphasis on adjusting premiums to adequately cover the risks associated with loans endorsed by FHA. Premium rate increases were among several measures taken by HUD to position FHA for quickly rebuilding the two percent required capital reserve ratio. With home prices still substantially below peak levels, and interest rates historically low, these premium rate increases have not unduly jeopardized FHA's role in providing an affordable mortgage financing option for low to moderate-wealth homebuyers. The six premium rate increases implemented by this Administration have, to date, bolstered the MMI Fund capital position by more than $23 billion.

Exhibit II-7 illustrates how actions taken to date with regard to credit policy and loan guarantee pricing have significantly improved the trajectory of the MMI Fund. Exhibit II-7 combines expected lifetime premium revenues and credit losses to depict the net economic value of each book, per the new actuarial estimates. This view further shows the improved trend of Fund finances. The 2010-2014 vintages have positive and increasing net economic value.

[10] Congress banned the use of FHA insurance on such loans in the Housing and Economic Recovery Act of 2008.
[11] Their ongoing effect is not only seen in the remaining home purchase loans from that era that could still result in an insurance claim, but also through streamline refinancing of those original loans that brought many of the 2005-2008 loans into new books.
[12] The net expected cost of those loans, as projected by the independent actuaries, grew over the past year to more than $16 billion.

Exhibit II-7
Book Value by Cohort



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

2. Projected Performance

The independent actuary's current projections indicate that the economic value of the Forward portfolio will increase in the future, rising by an average of 45 percent per year through FY 2021. The model assumptions include slower prepayment rates of the existing books of business based on rapidly rising interest rates, the continuation of current FHA market share levels and a strong housing market recovery. In addition, insurance-in-force (IIF) is expected to increase by an average rate of 3 percent per year through FY 2021. The independent actuary's assumption about FHA's continued and prolonged high market share presumes a protracted impairment of the role of other mortgage market institutions.

Any forecast of future FHA endorsement volumes depends critically on what the future holds for conventional mortgage lenders, private mortgage insurers, Fannie Mae and Freddie Mac. As these institutions, and in particular the mortgage insurers, have begun to reestablish higher market shares, FHA market share will likely revert to its historical norm. The independent actuary projects the FHA market share to settle around 15 percent of the total single-family mortgage market under these assumptions. Exhibit II-8 summarizes the projected performance over the next seven years.

Exhibit II-8
Projected Forward Portfolio Performance for FY 2014 to FY 2021 ($ millions)

Fiscal Year	Economic Value of the Forward Portfolio[a]	Unamortized Insurance in Force[b]	Amortized Insurance in Force[b]	Economic Value of Each New Book of Business	Volume of New Endorse-ments[c]	Investment Earnings on Forward Balances
2014	5,932	1,154,818	1,059,925	11,788	134,000	
2015	16,161	1,158,756	1,049,949	10,213	124,505	17
2016	24,201	1,184,196	1,060,024	7,851	113,488	189
2017	33,022	1,220,041	1,079,960	8,275	119,065	547
2018	43,780	1,264,146	1,107,688	9,712	136,883	1,046
2019	55,330	1,311,234	1,137,046	9,856	141,338	1,695
2020	67,349	1,362,153	1,168,977	9,747	147,547	2,272
2021	80,541	1,420,350	1,207,055	10,364	159,462	2,828

[a] All values are as of the end of each fiscal year. The economic value for FY 2014 through FY 2021 is equal to the economic value of the Forward portfolio at the end of the previous year, plus the current year's interest earned on the previous year's capital resources, plus the economic value of the new book of business.

[b] Estimated based on the data extract as of June 30, 2014 and projections of new endorsements and loan performance.

[c] Based on IFE volume forecast.

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

3. Alternative Scenarios

The realized economic value of the Forward portfolio will vary from the actuary's estimate if actual drivers of loan performance deviate from base-case projections. This section compares the base-case economic value derived from Monte Carlo simulations with seven alternative scenarios. The base-case of the actuarial study is the mean, or average, expected economic value of the Forward portfolio across 100 randomly generated economic paths. The first five alternative scenarios reviewed here are percentile marks among the actuary's 100 simulated paths. They correspond to those economic paths that yield the 10th best, 25th best, 25th worst, 10th worst and the singular worst projected economic values.

Exhibit II-9
Projected Forward Portfolio Economic Values by Alternative Scenarios ($ millions)

Fiscal Year	Baseline Monte Carlo	10th Best Path	25th Best Path	25th Worst Path	10th Worst Path	Worst Path	Moody's Protracted Slump	Moody's Baseline
2014	5,932	14,581	10,873	2,277	-3,040	-31,430	-40,010	10,075
2015	16,161	28,518	22,522	17,971	6,071	-26,119	-32,155	21,448
2016	24,201	38,867	30,657	29,391	14,739	-23,989	-25,390	30,405
2017	33,022	44,940	39,532	41,763	25,666	-21,082	-18,998	39,849
2018	43,780	50,876	48,737	52,187	38,715	-17,897	-12,598	50,862
2019	55,330	57,977	59,310	64,088	49,857	-13,946	-5,840	62,830
2020	67,349	64,432	70,046	76,507	68,994	-7,481	2,119	75,797
2021	80,541	66,427	81,461	85,155	96,905	-411	11,329	89,893

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

From the 25th best and worst paths, the MMI Fund's FY 2014 economic value has approximately a

50 percent probability of being in the range of $2.3 billion to $10.9 billion.

According to the independent actuary's worst stress scenario the economic value of the Fund can be as low as negative $31.4 billion precipitated by a rapid house price decline of 12 percent from FY 2015 through FY 2018 and then remain stagnant until FY 2022. There is a 99.5 percent probability that the FY 2014 economic value would be better than negative $31.4 billion. However, this value is not a floor. Recent history shows that the national drop in house prices was 20.4 percent over the 4 years from 2007 Q2 to 2011 Q2. That is, there is a small likelihood (less than 0.5 percent) that the economic value of the fund could be significantly lower than negative $31.4 billion as evidenced by the recent history of the Great Recession.

C. REVERSE MORTGAGE (HECM) PORTFOLIO

Loans in FHA's reverse mortgage program, the Home Equity Conversion Mortgage (HECM) program, are included in the MMI Fund beginning in 2009. They comprise a significantly smaller share of the total MMI portfolio than Forward loans, $97 billion compared to $1.1 trillion. The estimated economic value of the HECM portion of the MMI fund is *negative* $1.17 billion. This represents a decrease of $7.6 billion from 2013. Exhibit II-10 provides the baseline economic values of the HECM portfolio, IIF and new endorsements for FY 2014 through FY 2021.

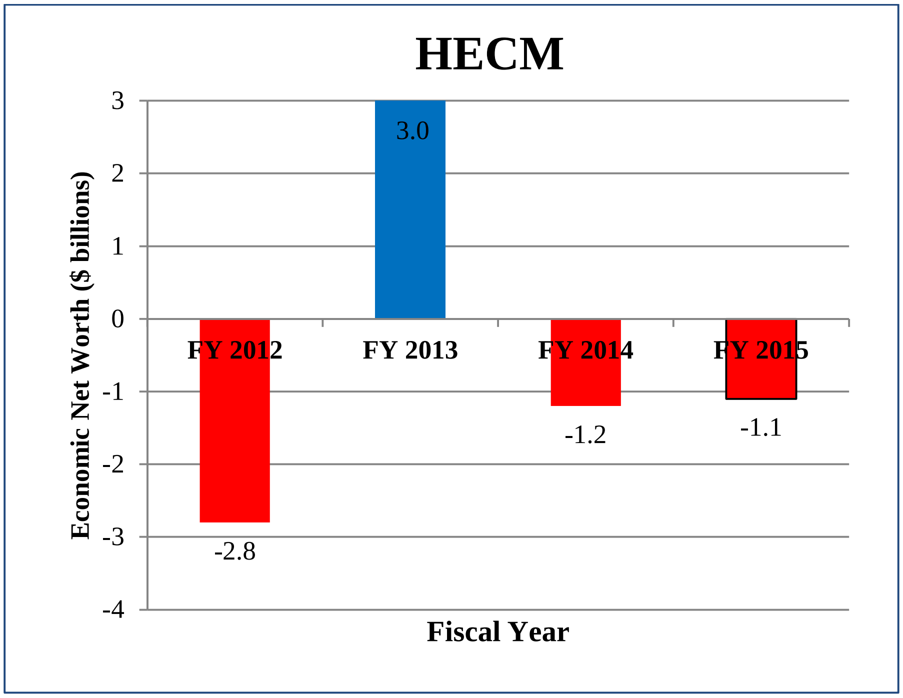
Exhibit II-10
Economic Value, Insurance-in-Force, and HECM Endorsements for FY 2014-FY 2021 ($ millions)

Fiscal Year[a]	Economic Value	Insurance in Force[b]	Volume of New Endorsements[c]	Economic Value of Each New Book of Business	Investment Earnings on HECM Balance
2014	-1,166	96,816	13,729	-513	
2015	-1,071	107,021	14,739	98	-3
2016	-794	112,942	16,381	290	-13
2017	-424	123,995	17,468	388	-18
2018	-121	135,241	18,581	317	-13
2019	191	146,700	19,726	316	-5
2020	591	158,253	20,869	393	8
2021	1,036	169,995	22,108	420	25

[a]All values, except the volume of new endorsements, are expressed as of the end of the fiscal year.
[b]Insurance-in-force is estimated as the sum of the MCAs of the remaining insured loans.
[c] Projections are based on the IFE HECM demand model times the average MCA. This volume number in FY 2014 reflects the outstanding loans at the end of the fiscal year, and excludes loans endorsed and terminated in the same fiscal year.
SOURCE: FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

Exhibit II-11 shows the actuary's estimated and projected values from FY 2012 through FY 2015. The pattern suggests that, unlike the case for the Forward portfolio, momentum for the HECM portfolio is less certain.

Exhibit II-11
Economic Value of HECM Portfolio 2012–2015



SOURCE: FY 2012, FY 2013, and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

The Actuary attributes $5.2 billion of the $7.6 billion decrease to a change in discounting assumptions. This same change in assumptions only marginally impacted the economic value of the forward portfolio. Given the nature of the HECM risk, where the majority of projected default occurrences lie twenty to thirty years in the future, small changes in assumptions or performance trends lead to relatively large changes in projections. This can be seen by a comparison of alternative scenarios between Forwards (Exhibit II-9) and HECMs (Exhibit II-12 below).

Exhibit II-12
Economic Values of the HECM Portfolio under Different Economic Scenarios ($ millions)

Fiscal Year	Baseline Monte Carlo	10th Best Path	25th Best Path	25th Worst Path	10th Worst Path	Worst Path	Moody's Protracted Slump	Moody's Baseline
2014	-1,166	11,998	7,736	-8,908	-15,343	-33,671	-11,706	-189
2015	-1,071	12,995	8,653	-8,861	-17,551	-35,701	-11,556	271
2016	-794	13,982	9,535	-8,500	-19,565	-38,264	-11,742	1,013
2017	-424	15,080	10,841	-7,960	-20,817	-41,354	-11,670	1,847
2018	-121	16,942	12,804	-7,421	-22,394	-44,927	-11,409	2,730
2019	191	19,214	15,050	-6,843	-24,276	-49,072	-11,042	3,706
2020	591	21,406	17,291	-6,559	-26,266	-53,829	-10,609	4,775
2021	1,036	24,435	19,240	-5,902	-28,222	-59,277	-10,109	5,943

NOTE: All values are expressed as of the end of the fiscal year.

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

Looking at the 10th worst path for both portfolios, we observe reduced economic value of $14.2

billion for HECMs compared to about $9 billion for Forwards, roughly 150 percent higher for HECMs. When taking into account the difference in portfolio size, ($96 billion for HECM versus $1,060 billion for Forwards), FHA concludes that the HECM portfolio is well over ten times more volatile than the Forwards. All this suggests that small changes to the HECM program can exert a relatively large impact on the overall value of the portfolio.

D. ADJUSTMENTS TO CONFORM TO FEDERAL CREDIT REFORM

The MMI programs are bound by the valuation methods required in the Federal Credit Reform Act (FCRA) and the supporting OMB Circulars. Where Federal loan guarantee programs are concerned, the FCRA and its supporting circulars prescribe the methods which must be followed in estimating the net present value of future cash flows from loan guarantee programs for budgetary purposes. This includes measurement of the degree of protection provided to taxpayers by the economic value and capital ratio of the MMI Fund.

The methods required by FCRA include the use of a unique and constant discount rate for each annual cohort of endorsements that reflects prevailing interest rates present at the time the budget for the cohort was developed. For example, cash flows related to a 1992 cohort will be, for the entire life of the cohort, discounted using the same unique discount rate assigned to it at the time the budget for the cohort was developed. Similarly, the cash flows related to FY 2010 endorsements will be discounted using the same unique discount rate assigned to it during its budget development.

Whereas the FCRA requires HUD to comply with government-wide discounting procedures, the National Housing Act requires that HUD procure an independent actuarial study of the MMI Fund each year in order to obtain an independent outside assessment of the Fund’s long-term capital position. To complete this assessment, the actuary must select and apply discount rates as part of its valuation. The actuary has exercised its independence in the 2014 Independent Actuarial Review to use discount rates which are different from those required by FCRA. Differences caused by alternative discount rate methods are not caused by differing views on loan performance, claim rates, or recoveries against claims. Rather, differences caused by alternative discount rates are unrelated to loan performance.

As shown in Exhibit II-13, use of FCRA compliant discounting results in materially different valuations of the MMI Fund and its components as of September 30, 2014.

The FCRA compliant valuation of the Forward portfolio is $1.66 billion greater than that of the independent actuary at $7.59 billion compared with the actuary’s $5.93 billion; the FCRA compliant capital ratio of the Forward portfolio is 0.72 percent compared with 0.56 percent using the actuary’s valuation.

The FCRA compliant valuation of the HECM portfolio is $1.37 billion greater than that of the independent actuary at positive $202 million compared with the actuary’s negative $1.17 billion; the FCRA compliant capital ratio of the HECM portfolio is positive 0.21 percent compared with negative 1.20 percent using the actuary’s valuation.

The FCRA compliant valuation of the MMI Fund is $3.03 billion greater than that of the independent actuary at $7.80 billion compared with the actuary’s $4.77 billion; the FCRA compliant capital ratio of the MMI Fund is positive 0.67 percent compared with 0.41 percent using the actuary’s valuation.

Exhibit II-13
Difference in MMI Fund Capital Ratio Due to Discounting as of 9/30/2014 ($ millions)

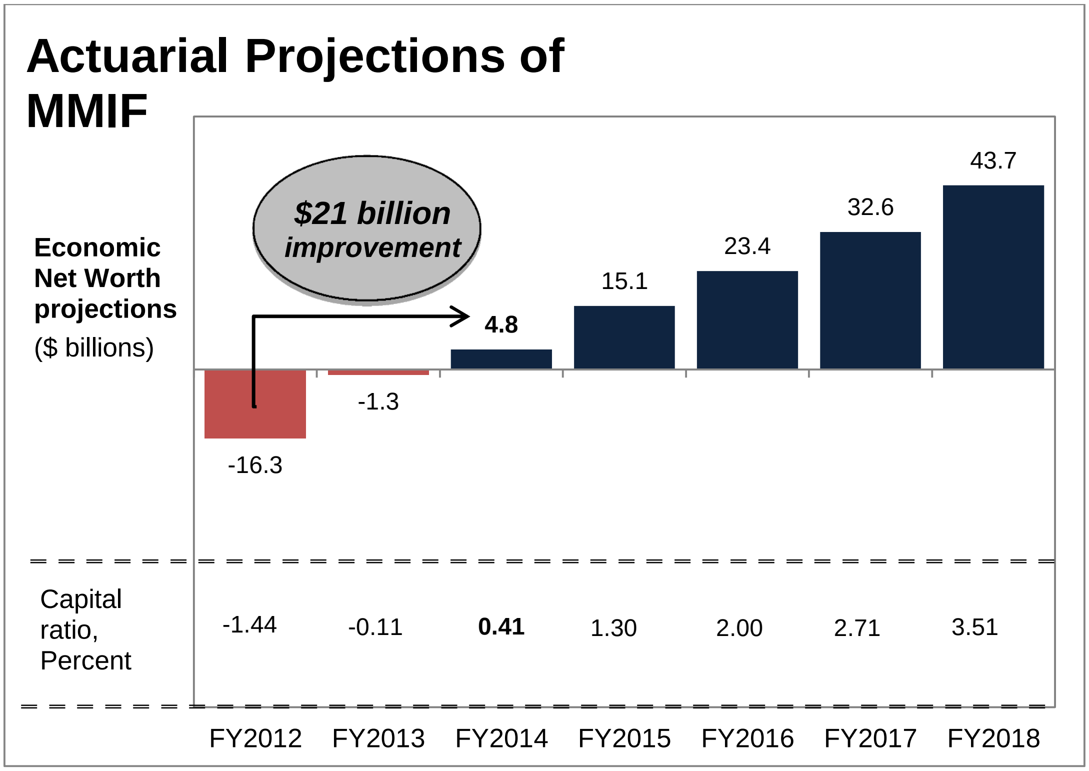
			As Discounted in Actuarial Reports			Discounted As Required By Federal Credit Reform		
Program	Insurance-in-Force	Capital Resources	Net Present Value of Future Cash Flows	Economic Value	Capital Ratio (%)	Net Present Value of Future Cash Flows	Economic Value	Capital Ratio (%)
Forwards	1,059,925	19,616	(13,684)	5,932	0.56	(12,022)	7,594	0.72
HECM	96,816	8,816	(9,982)	(1,166)	-1.20	(8,614)	202	0.21
MMI Fund	1,156,741	28,432	(23,666)	4,766	0.41	(20,636)	7,796	0.67

SOURCE: U.S. Department of HUD/FHA, October 2014.

III. Capital Restoration Plan

The MMI Fund is now positive, having improved by $21 billion over the past two years. It now stands at $4.8 billion in economic value with a capital ratio of 0.41 percent.

Exhibit III-1
Economic Net Worth Under Base-Case Estimates, 2012–2018



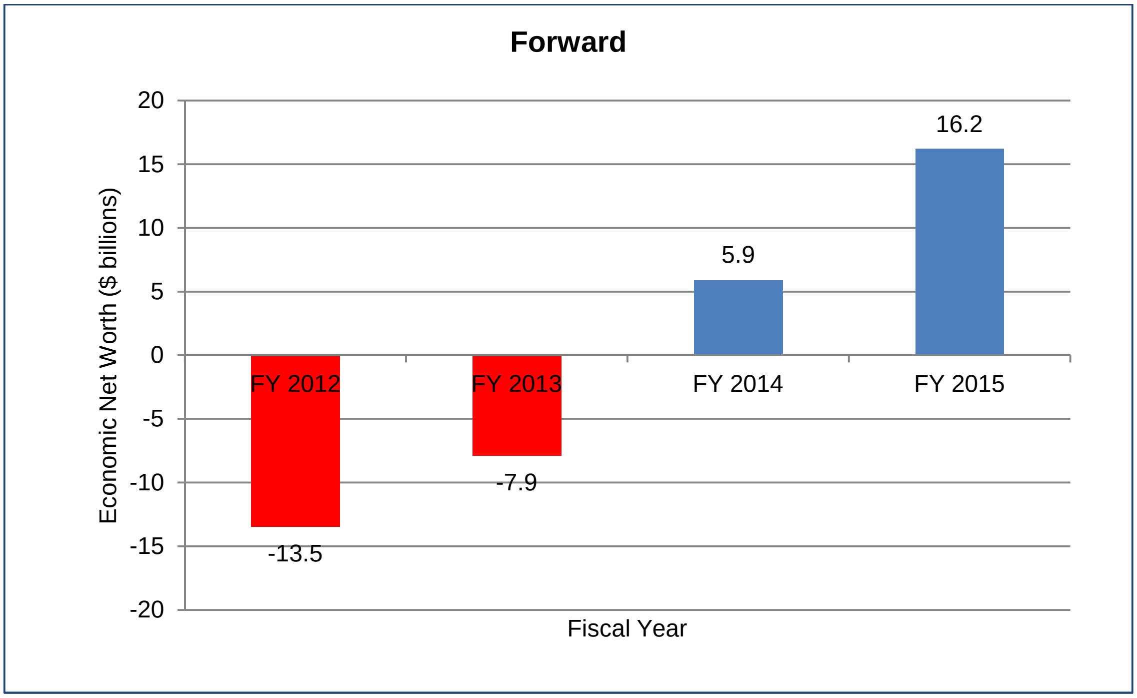
SOURCE: FY 2012, FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

A. ACTIONS TAKEN TO STRENGTHEN THE FORWARD LOAN PORTFOLIO

The performance of the Forward portfolio was the primary driver behind the improvement to the MMI Fund. As illustrated in Exhibit III-2, the Forward portfolio first showed a negative value in FY 2012 and has since improved to $5.9 billion, a swing of over $19 billion. Significant actions taken starting in 2009 to strengthen credit policy on newer books of business and improving recoveries on legacy loans led to this result.

These actions supported two key strategies FHA took to place the fund on its current positive trajectory: 1) restructured pricing to match risk and build capital reserve in FHA's more recent books, and 2) contained losses from the legacy portfolio.

Exhibit III-2
Economic Net Worth Under Base-Case Estimates, 2012–2015



SOURCE: FY 2012, FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

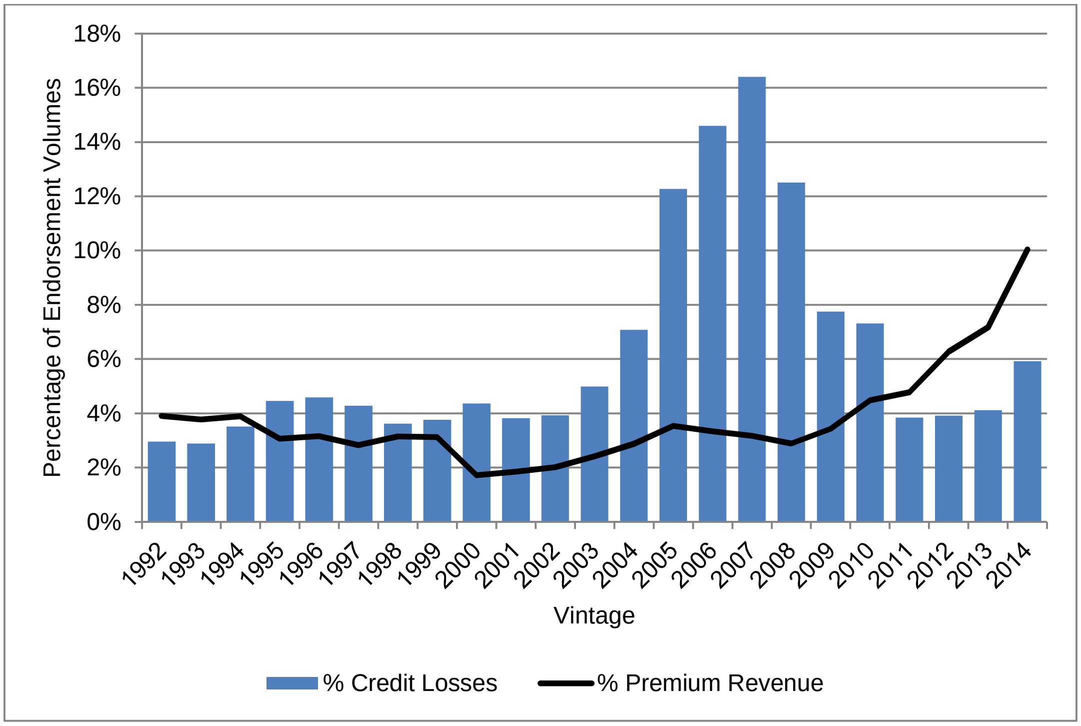
1. Restructured pricing to match risk and build capital reserve

FHA aligned pricing and credit policies to promote sustainable lending by a) strengthening pricing to systematically contribute to a capital cushion and b) putting in place prudent risk limits that continue to support the FHA mission.

a) **Strengthen pricing to systematically contribute to a capital cushion.** FHA pricing in the past was structured to cover average claim losses. This pricing structure relied heavily on lower risk loans subsidizing the cost of higher risk loans. While this break-even pricing approach may be appropriate for most government lending programs, it is not suitable for a program required to maintain a capital reserve. Until 2008, average mortgage insurance premium (MIP) revenue could only cover average losses, as shown in Exhibit III-3.

   This extreme subsidized pricing approach exposed FHA to product mix risk. When the share of high risk loans abruptly increased in 2007 and 2008, MIP revenue was insufficient to cover expected losses of the higher risk loans coming into FHA, even before layering on stress-level losses that soon followed. A pricing structure was needed that would a) rely less on a high volume of low risk loans to cover costs associated with high risk loans and b) systematically build a capital cushion that would protect the Fund during periods of economic stress.

Exhibit III-3
Premium Revenue and Credit Losses by Vintage



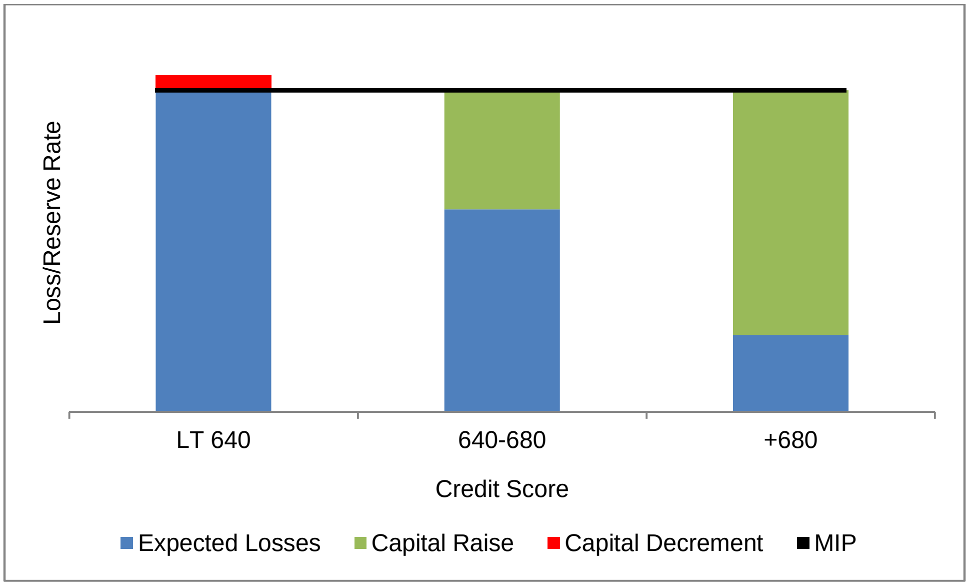
SOURCE: FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

As shown in Exhibit III-3, price increases were implemented, beginning in 2009, to both cover average claims losses and contribute to a reserve as well. This includes pricing changes that came after Congress gave FHA authority to further adjust annual premium pricing in 2010. Strengthened pricing was the first component of a two-pronged strategy, as it is a necessary, but not alone sufficient, condition to establishing a sustainable, self-funding model for lending that is consistent with FHA's mission.

b) **Establish claim loss limits consistent with continued access to credit.** Establishing a pricing approach that corresponds to average loss expectations addresses sustainability over the long term and during periods of normal market conditions. However, it could still leave FHA vulnerable to extreme losses during times of economic stress if the amount of risk is left unlimited.

To address the added risk experienced in times of economic stress, FHA defined maximum claim loss tolerance at an individual loan level. Hard cutoffs (e.g., minimum credit scores) were not the dominant approach. Instead, FHA relies on risk-based underwriting to discourage extreme risk layering for higher risk loans while still enabling the use of compensating factors, as appropriate. To accomplish this, FHA reset its Technology Open to All Lenders (TOTAL) Scorecard tolerances to refer higher risk loans to manual underwriting. Equally important, FHA's manual underwriting guidelines were strengthened to discourage extreme risk layering. For example, manual underwriting is now required for credit scores under 620 and a high debt-to-income ratio. This approach makes the Fund less reliant on subsidies provided by low risk loans, as illustrated by Exhibit III-4.

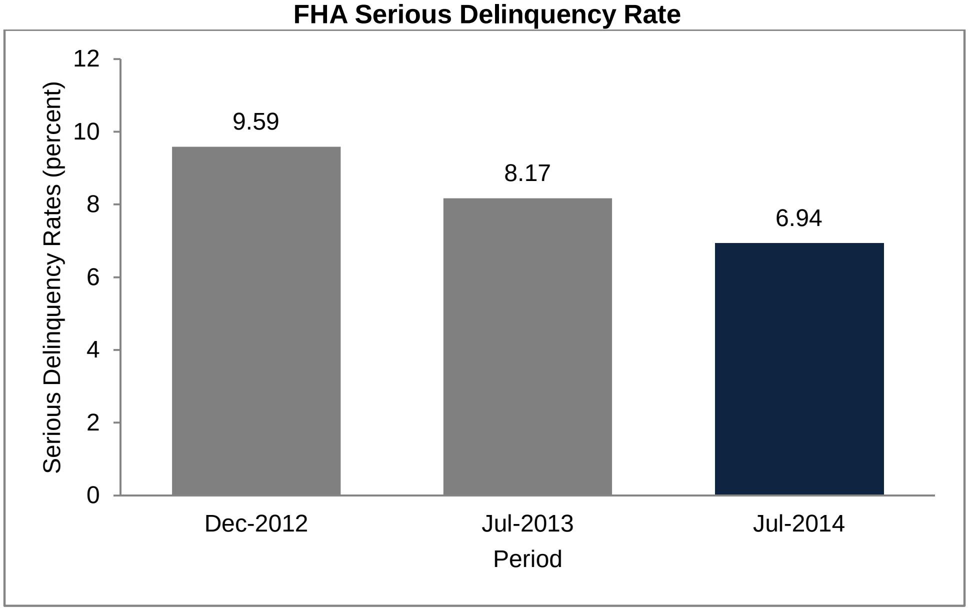
Exhibit III-4
Capital Contribution by Credit Score Band



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

Improvement in the quality of FHA's more recent vintages is represented by a significant decrease in the serious delinquency rate. As shown in Exhibit III-5, seriously delinquent loans have fallen 28 percent over the last two years.

Exhibit III-5
FHA Serious Delinquency Rate



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

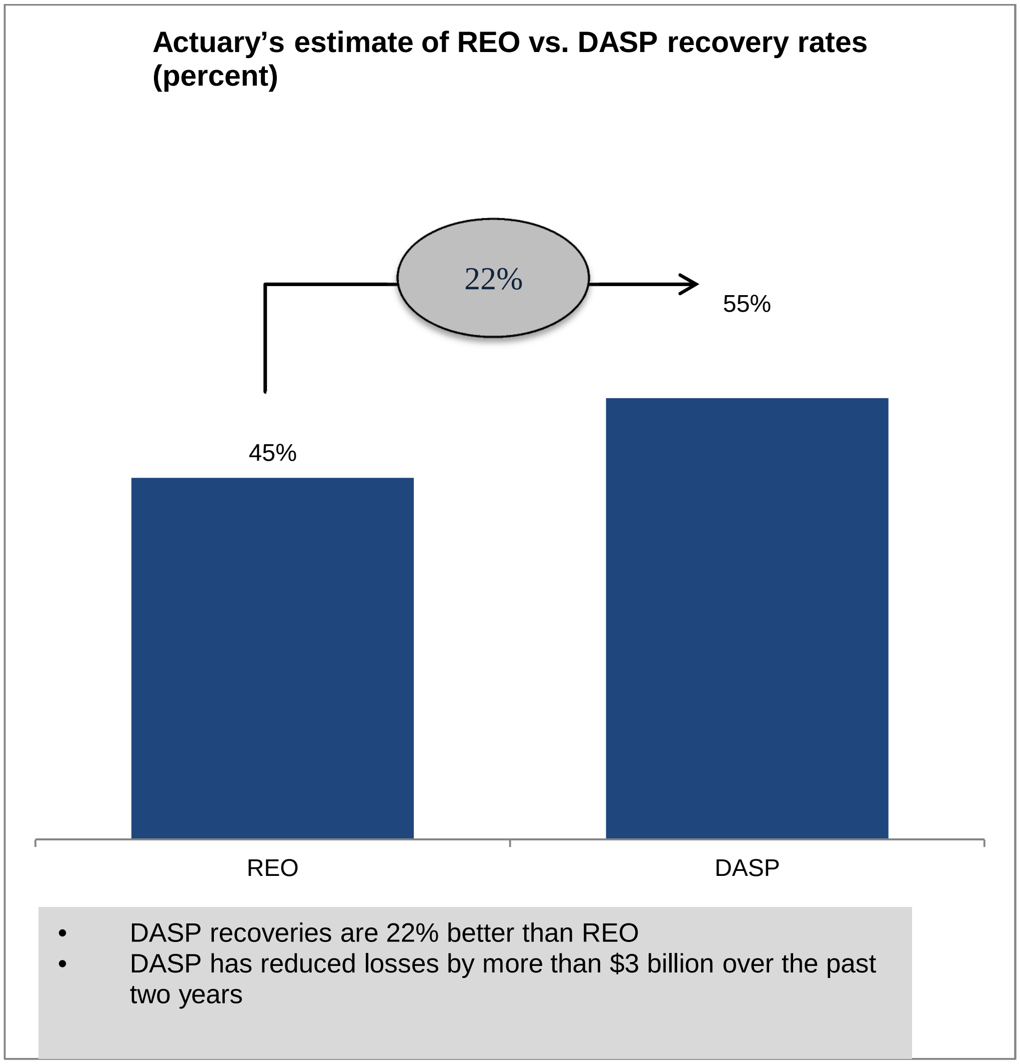
2. Enhanced Asset Disposition Strategy

The second key strategy to increasing the value of the Fund has been to reduce the impact of poorly performing legacy loans. The actuary projected over $50 billion in claims from loans with serious delinquencies in the FY 2013 review, highlighting the importance of loss mitigation efforts. In response, FHA continued focus in FY 2014 on further reducing loss severities associated with the legacy book. FHA delivered on this commitment, in large part through execution of an overall asset management strategy aimed first at increasing the success rate of modification programs designed to keep borrowers in their homes. This was primarily accomplished through enhancement of existing loss mitigation tools such as short sales, modification programs, and streamlined refinancing.

If these remedies did not achieve the goals, expansion of existing, but rarely used programs were utilized to provide an alternative to REO disposition. FHA successfully expanded existing initiatives such as the Distressed Asset Stabilization Program (DASP) and Third Party Sales (TPS). Each is described below.

a) **Expansion of the Distressed Asset Stabilization Program (DASP).** FHA began expanding the DASP initiative in 2013, selling more than 33,700 nonperforming loans. This momentum continued through 2014, in which another 40,000 non-performing loans were sold through a competitive bidding process. Through DASP, defaulted notes are sold in bulk to third party purchasers without ever being conveyed to FHA. FHA's analysis has shown that disposing of defaulted assets in this manner generally yielded lower losses for the MMI Fund than would have been realized by selling these same assets through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing these assets as REO property were eliminated. DASP has been especially useful in clearing up the backlog of seriously delinquent loans that have been in the foreclosure pipeline. The positive financial impact of DASP is illustrated in Exhibit III-6.

Exhibit III-6
DASP Results

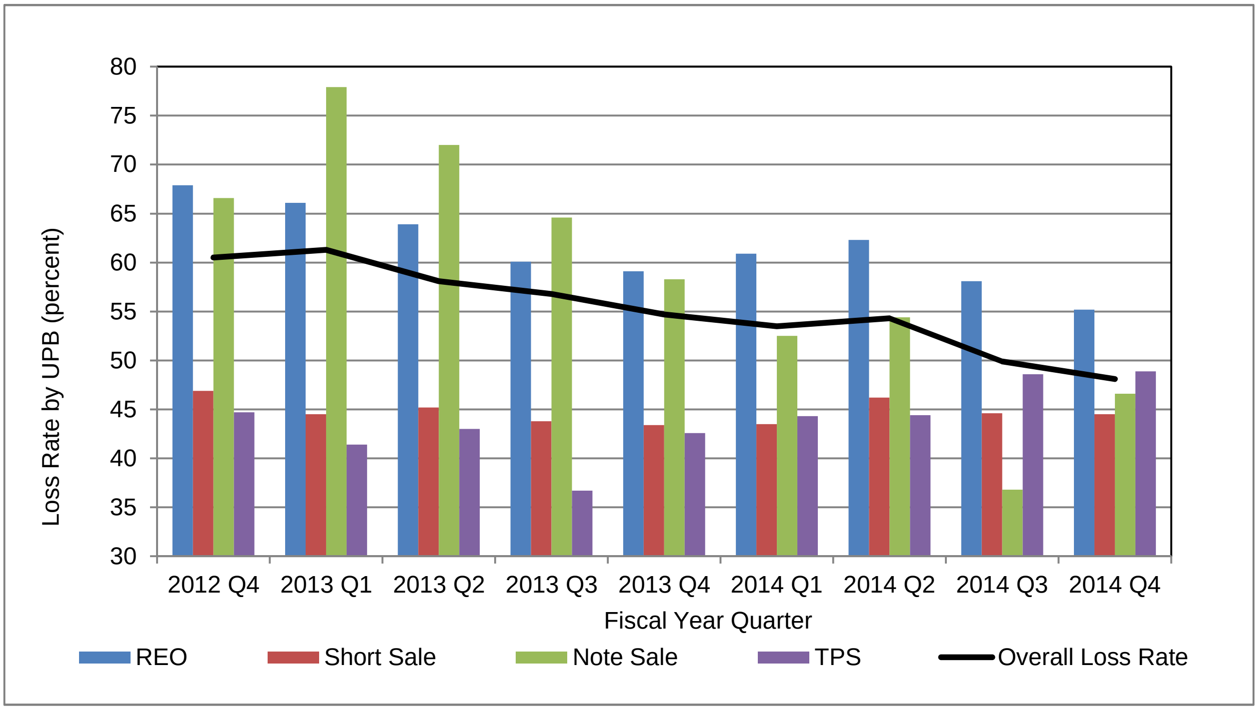


SOURCE: FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

b) **Expansion of the Third Party Sale (TPS) Program.** Similar to DASP, through the Third Party Sale (TPS) program, individual foreclosed properties secured by non-performing FHA-insured loans are offered for sale to third party purchasers before conveyance. TSP auctions are of individual properties, unlike DASP, which are used to sell pools of loans in a bulk sale. As with DASP, FHA's analysis has shown that this method of disposition yielded lower losses for the MMI Fund than selling them through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing an REO property were eliminated. Participation in this program has expanded from 5 percent of dispositions in FY 2013 to 15 percent in FY 2014. FHA expects this to increase significantly in FY 2015.

Prior to 2010, REO alternatives (primarily short sales) had comprised only about 10 percent of total dispositions per year. The share of REO alternatives increased moderately 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 over 50 percent over the last two years. The net effect of these efforts is summarized in Exhibit III-7.

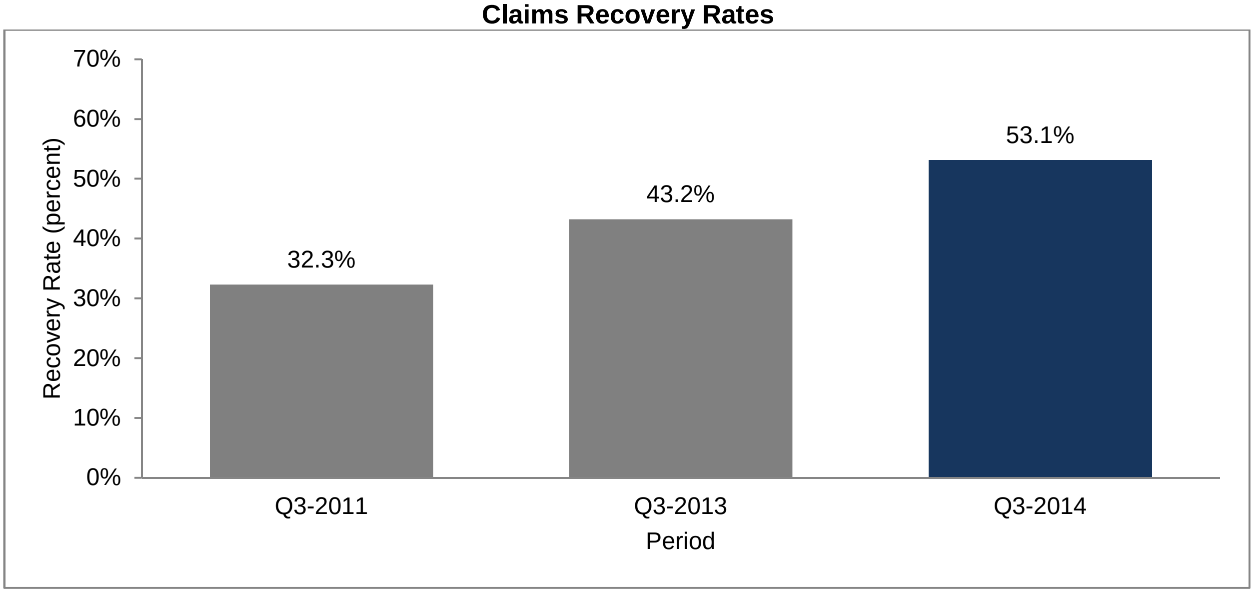
Exhibit III-7
Asset Disposition Performance
Loss Severity and Share of Disposition by Type of Disposition Strategy



SOURCE: FY 2014 Actuarial Reviews of the MMI Fund; 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 III-8, claims recoveries have improved by 64 percent over the last two years, adding over $5 billion to the MMI Fund over that time.

Exhibit III-8
Claims Recovery Rates



SOURCE: FY 2012, FY 2013, and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

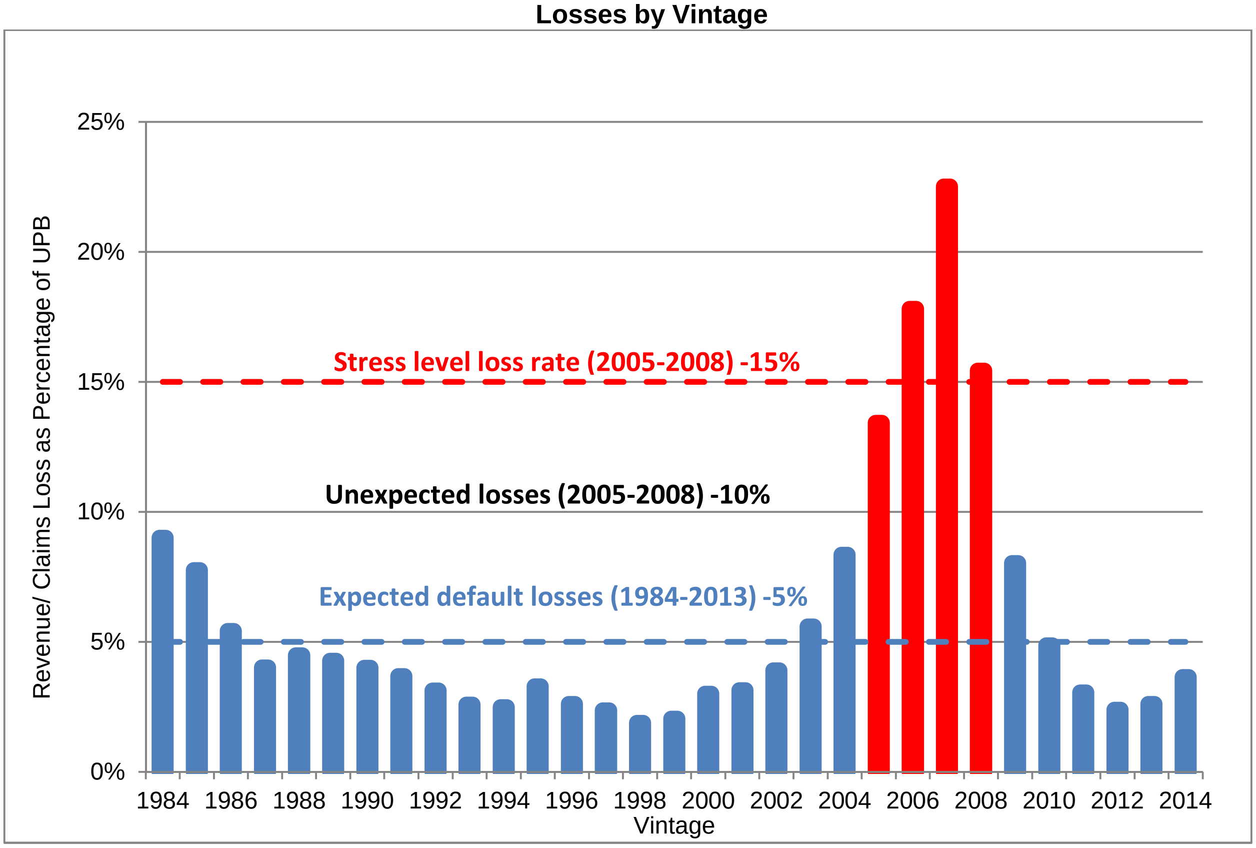
B. PLANNED ACTIONS TO MAINTAIN MOMENTUM AND MANAGE RISKS

As discussed, steps taken since 2009 have improved the Fund's performance of the Forward portfolio for the last two years and positioned it for continued growth in the future. Exhibit III-1 shows that the actuary now forecasts the Fund will reach a 2 percent capital ratio in 2016. The next section describes key elements of FHA's capital restoration plan including a long term MIP pricing strategy.

1. Long term MIP Strategy

MIP price structure is comprised of two components: 1) the portion required to cover normal (expected) losses of FHA's credit business; and 2) what is required to establish a capital reserve cushion to support the Fund in a crisis. Exhibit III-9 illustrates these two concepts.

Exhibit III-9
Losses by Vintage



SOURCE: FY 2012, FY 2013, and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

a) **Pricing required to cover normal or expected losses.** We refer to pricing that just covers average or expected losses as "breakeven" pricing. This year's Independent Actuarial Report applied FHA experience for vintages between 1984 and 2013. We estimate FHA's average claims losses for this time period (excluding 2005 – 2008) at roughly 5 percent. Going forward, we estimate expected losses for FHA's target mix at 5.5 percent. The breakeven portion of the MIP should just cover this level of losses.

b) Raising a capital reserve. By definition, breakeven pricing cannot systematically fund a capital reserve. Capital can only be raised systematically through fee income. (Capital can also be raised through rising house price appreciation (HPA), but this form of capital disappears in times of stress.) This means MIP pricing needs to be greater than breakeven to systematically fund a reserve. How much higher than breakeven depends on two key factors:

- Size of the reserve (how much capital is needed?)
- What is the appropriate aggregation period?

Each question is addressed below.

i. What is the appropriate capital reserve?

History has shown that the capital ratio reacts much more quickly to downward shifts in house price appreciation (HPA) than can be addressed by policy measures. For example, the MMI Fund lost over $10 billion three separate times between 2008 and 2011 due to successive downward HPA shifts. On the other hand, the most effective policy countermeasures (e.g., MIP increase) can only increase capital by $1 - $2 billion in a year. Taken together, this fact pattern suggests that:

1) The capital ratio is far more sensitive to sudden negative HPA shifts than to policy countermeasures.
2) The negative impact of recessions only becomes apparent several years after the fact—too late for counteracting policy response to be immediately effective.

Exhibit III-10
MMI Capital Ratio, 2007–2011

Vintage	FHA Portfolio ($ billions)	Capital Ratio (%)	Capital Cushion ($ billions)
2007	343	6.4	21.9
2008	474	3.0	14.2
2009	697	0.5	3.7
2010	899	0.5	4.5
2011	1,015	0.2	2.4

SOURCE: FY 2007–FY 2011 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

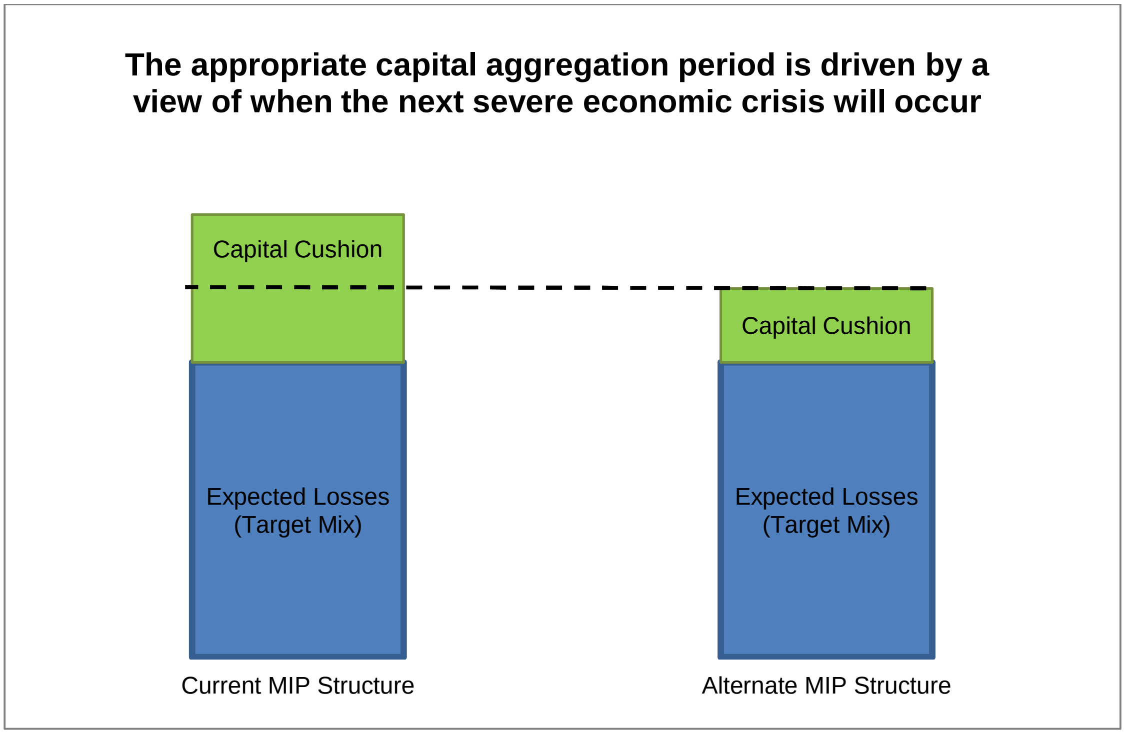
If we assume that the portfolio will remain at more than $1 trillion in IIF, than using the recent crisis as an example, the net present value (NPV) of losses for the FHA portfolio at its trough is expected to be $85 billion (roughly 8.5 percent on a $1 trillion portfolio). This suggests that FHA would need $85 billion NPV in claims-paying capacity in the next crisis similar to the Great Recession.

Claims-paying capacity comes to FHA in two forms, MIP revenue and Capital Resources, which functions as a sort of reserve fund, accreting from excess MIP revenue not used to pay claims. Given projected steady state MIP income stream of $40 billion (4 percent), this suggests that FHA should continue to build a reserve that reaches $45 billion. $45 billion of reserves combined with $40 billion of MIP income stream together will provide $85 billion of claim-paying capacity.

ii. What is the appropriate aggregation period?

The Actuary currently estimates that it will take another four years to build a reserve of $45 billion. The question is whether this is sufficient time or not. How long it takes to build up necessary reserves depends on when we would expect the next "Great Recession" to occur. It's important to remember that these reserves are meant to withstand losses in an event similar to the Great Recession. We differentiate this type of even from "normal recessions" (Exhibit III-11). Average pricing is structured to handle a serious recession such as we experienced in the early 1980s or early 2000s. The $85 billion in claims paying capacity is what would be needed to withstand a more serious economic crisis such as the Great Recession or the Great Depression. Only two of these events have occurred over the past 100 years, separated by more than 75 years. So if history is of any guide, we have several decades to build these reserves. However, we are taking a conservative view and assuming another Great Recession or crisis with a similar magnitude is unlikely over the next 20 years.

Exhibit III-11



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

2. Pursue Actions That Simultaneously Increase Access to Credit and Strengthen the MMIF

In FY 2015, FHA will place significant focus on finding opportunities to simultaneously increase access to credit while also strengthening the fund. Discussions with real estate industry and related stakeholders indicate that perceived risks of doing business with FHA causes some lenders to curtail lending to some of the populations FHA has historically served, thus challenging the successful realization of FHA's mission. FHA has introduced a number of initiatives designed to reduce some of the risks perceived by lenders.

a) **New Quality Assurance Taxonomy.** In July 2013, FHA sought feedback from stakeholders on potential changes to its quality assurance framework via discussions and comments received on FHA Handbook revisions. The commentary received through this process reflected a consistent desire for FHA to be clear and transparent in defining manufacturing defects and underwriting standards; to establish different severity levels with commensurate consequences; to consistently apply these standards and communicate results to lenders; and to consider adjustments to the compare ratio to allow for a more refined analysis of lender performance.

   FHA carefully considered the comments received, and throughout FY 2014, FHA worked diligently on a new Quality Assurance Defect Taxonomy to find a way to simplify and more effectively communicate quality control results to FHA lenders, increasing the transparency of the process. 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. The proposed taxonomy was posted on FHA's Single Family Drafting Table on September 16, 2014 to solicit additional industry feedback.

   FHA will once again carefully consider any feedback received while pursuing enhancements to its Quality Assurance Defect Taxonomy and enforcement framework in FY 2015. Through these changes, FHA hopes to provide the clarity necessary for FHA-approved lenders to cease utilizing credit overlays that unnecessarily inhibit credit access for responsible borrowers who meet FHA's underwriting requirements.

b) **Publication of New Single Family Handbook.** FHA will continue to work toward the publication and effective dates of its new Single Family Handbook, which will be the single, authoritative source for all Single Family housing policy. Although the Handbook is being issued in individual sections for industry review and feedback, FHA plans to publish the final Handbook in its entirety and set an effective date by the end of FY 2015. On June 30, 2014, FHA posted two Single Family Handbook sections for feedback—Doing Business with FHA: Lenders and Mortgagees and Quality Control, Oversight and Compliance. The draft Doing Business with FHA section contains information regarding eligibility, approval, and recertification requirements for FHA lenders. The draft Quality Control, Oversight and Compliance section explains ongoing lender responsibility to perform institution and loan-level quality control. The posting of these two sections is a continuation of FHA's overall effort to develop a comprehensive Single Family Handbook that will be, at its completion, the single, authoritative source for all Single Family housing policy.

c) **Supplemental Performance Metric.** Additionally, FHA plans to enhance its quality assurance practices in FY 2015 by implementing a supplemental performance metric. In the fall of 2012, FHA removed non-credit qualifying streamline refinances from lenders' compare ratios and from the public view in Neighborhood Watch. While this was a step in the right direction, FHA has continued to see the restriction of access to credit due to lender overlays, especially as it relates to borrower credit scores.

In FY 2014, FHA proposed the implementation of a supplemental performance metric that would compare a lender's performance to a targeted risk mix that includes default and claim rates, as well as borrower credit scores. This metric would compare lender performance to FHA's targeted rate, rather than to their peers. FHA plans to implement the supplemental performance metric in FY 2015.

d) Housing Counseling. The Office of Housing launched a number of initiatives to incorporate housing counseling into FHA single family lending programs under the umbrella name HAWK (Homeownership Armed With Knowledge). HUD has created a multi-office HAWK team of more than 50 people, and used research findings and other evidence to build policies that will both strengthen the MMIF as well as contribute to the sustainability of home ownership for families using FHA-insured products. The Office of Housing Counseling and the Office of Single Family Mortgage Insurance Programs are jointly leading the HAWK initiatives, which link HUD-approved housing counseling agencies to FHA origination and servicing policies.

In 2014, HUD expanded its work on HAWK initiatives in a number of ways.

- HAWK for New Homebuyers–On May 13, 2014, HUD published a Federal Register Notice proposing a pilot program to provide incentives in the form of reductions in the FHA mortgage insurance premiums for first-time homebuyers who complete housing counseling prior to making a decision about homeownership. Participants would also agree to participate in a housing counseling program during their first year of homeownership, and could receive additional incentives based upon loan performance during the first two years of their loans. HUD has received more than 400 comments from nearly 100 stakeholders about the program addressing issues such as the counseling curriculum, what discounts to the premiums FHA should offer, and whether to expand it to all borrowers with loans backed by the agency. HUD will complete its deliberation of the comments and intends to launch the pilot in 2015.

- HAWK Modification Success Program. The HAWK team is designing a program to link defaulting FHA borrowers to HUD-approved housing counselors in the course of obtaining a loan modification. This program is modelled on similar programs designed by the Treasury Department and Fannie Mae, and is planned for 2015.

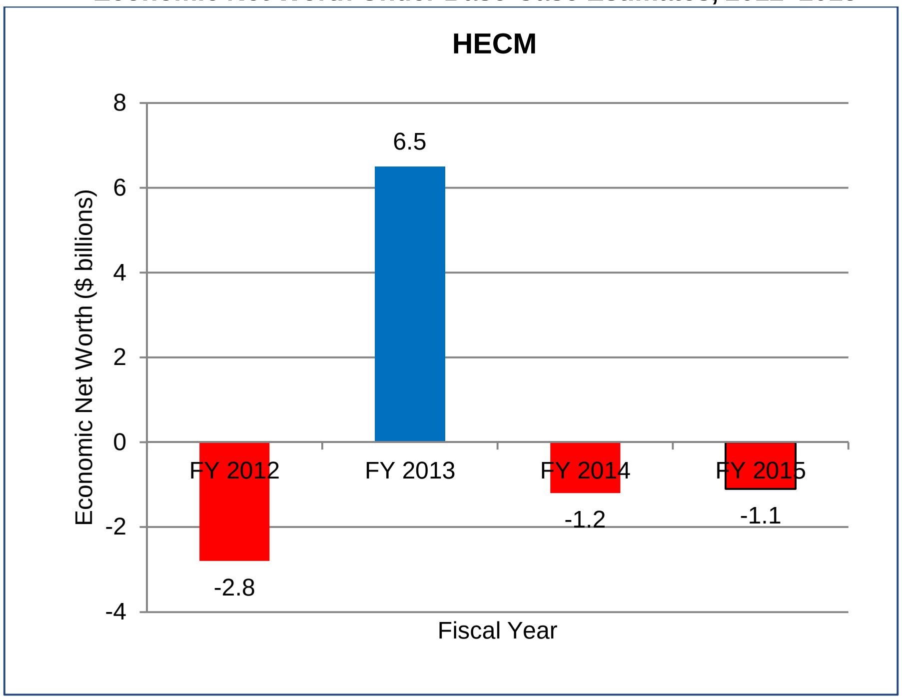
- HUD will introduce new, user-friendly material to inform FHA borrowers about HUD's housing counseling program after the first delinquency. This Borrower Notification will be introduced in 2015.

- HUD will make systems changes in 2015 in order to track the number of FHA borrowers who benefit from HUD-approved housing counseling.

C. ACTIONS TAKEN TO STRENGTHEN THE HECM PORTFOLIO

Exhibit III-12 shows that HECM portfolio is facing less positive momentum than the Forward portfolio. As a result, FHA must continue to proceed cautiously with HECMs to see if stabilizing measures already in motion affect their intended results. In 2014 the HECM Fund's economic value declined to negative $1.2 billion. While FY 2013 appears to be a significant improvement from FY 2012, the FY 2013 economic value number reflects cash infusions from the Forward program and from the mandatory appropriation raising its value only temporarily.

Exhibit III-12
Economic Net Worth Under Base-Case Estimates, 2012–2015

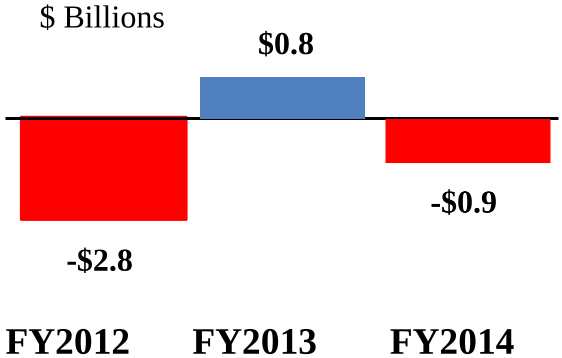


SOURCE: FY 2012, FY 2013 and FY 2014 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

FHA began undertaking additional actions to stabilize the HECM portfolio during the second quarter of FY 2014, well ahead of the Actuarial findings. We expect some of the actions resulted in significant changes to the program in late 2014. Other actions are expected to become effective by FY 2015 Q1, as summarized by Exhibit III-13.

Exhibit III-13
Actions Taken to Stabilize the HECM Portfolio

HECM Economic Value – Actuary's estimates
$ Billions



$4 billion transfer of capital from Forwards and $1.7 billion mandatory appropriation ("draw") netted from 2013 result

Continue to take aggressive action to stabilize HECM

Example actions taken to improve HECM program

1. Adjustments to Principal Limit Factors
2. Limiting Maximum Draws in the first year
3. Eliminating fixed-rate lump sum draws
4. Establish non-borrowing spouse deferral period
5. Prohibition on misleading or deceptive advertising/marketing

Additional actions in progress

1. Publish and implement revised HECM financial assessment and property charge set aside guide
2. Address policies regarding treatment of ineligible non-borrowing spouse
3. Issue proposed rule formalizing all regulatory changes made under the HECM Stabilization Act authority.
4. Draft and publish HECM Handbook to clarify rules and simplify

Due to the nature of the HECM product, there are two unique aspects to managing policy: 1) the portfolio is highly sensitive to small changes and 2) the impact of policy changes on the portfolio does not become apparent immediately. It is still too soon to know what impact these changes will exert on the HECM program. Therefore, FHA will continue to monitor progress of actions taken to date and continue to make further adjustments to the program as needed, just as we have in 2013 and 2014.

FHA is closely monitoring the substantial number of new and amended policies were put into place during FY 2014:

- FHA revamped HECM product structure under authority granted by the Reverse Mortgage Stabilization Act of 2013. Of note were risk reducing amendment including new Fixed and ARM products with initial draw limits, Limited Fixed Rate HECM to one time draw at close.

- Limit on draws at close (Fixed Rate HECM) and an Initial Disbursement Period (first 12-months) for ARM HECM.

- Initial MIP based on initial draw percentage (0.50 percent for initial draw of 60 percent or less of principal balance and 2.50 percent for initial draw exceeding 60 percent of principal limit).

- Limit Initial Draw to greater of 60 percent of Principal Limit or Mandatory Obligations plus 10 percent.

- Limit Fixed Rate HECM to one draw at close, subject to the maximum draws and new MIP structure.

- A Prohibition on Misleading or Deceptive Advertising/Marketing was issued to protect consumers and the FHA fund from the negative financial impacts and risks of such practices.

- New Principal Limit Factors were implemented based on extensive analysis regarding the management of risk related to changing house price values, the percentages of value that is prudent to borrow and the structure of the loan payouts.

- A Non-Borrowing Spouse Deferral Period was implemented for case numbers assigned on, or after August 4, 2014.

- Revised Manual Underwriting Requirements, required compensating factors and cash reserve requirements (ML 2014-02).

Additional actions underway for final implementation in FY15

- Publish and Implement Revised HECM Financial Assessment and Property Charge Set Aside Guide previously published in Mortgagee Letter 2013-28. Policy changes were made in response to public comments received from publication of Federal Register Notice and further review by HUD.

- Publish proposed rule formalizing all regulatory changes made under the Reverse Mortgage Stabilization Act of 2013 authority. The proposed rule will include additional new HECM proposed policy.

- Draft and publish HECM Handbook for industry feedback, complete clearance and publication to consolidate program information in one definitive, easily accessible source (similar to the single source Single Family Handbook related to Forward mortgages).

Conclusion

The latest results from the independent actuary clearly indicate FHA's efforts are working. The economic value of the MMI Fund has improved by $21 billion dollars over the last two years and the Fund's capital reserve ratio is expected to reach the required two percent level in 2016. According to the actuary, policy changes made by FHA account for much of the improvement in key performance metrics, such as premium revenue, credit quality, and recovery rates.

Throughout its nearly 80 year history, FHA has played an important dual role in the nation's housing finance system, helping more than 40 million American families own or refinance a home, and stepping in numerous times to stabilize regional and national housing markets during periods of economic crisis. During the most recent crisis – the most severe since FHA's creation in the wake of the Great Depression – the agency again played its vital countercyclical role, ensuring that liquidity and credit access remained when private capital sources receded from the market. Providing stability and continuity in a struggling economy necessarily included additional risk for FHA and its MMI Fund. Over the past five years, this Administration has worked tirelessly to protect and strengthen the MMI Fund and position FHA for a healthy and successful future.

As FHA enters its eighth decade of service to American households, it will continue to aggressively pursue strategies that simultaneously enhance credit access for underserved borrowers and limit losses to the MMI Fund. The past six years – some of the most challenging the agency has ever faced – have proven that FHA can and must accomplish both goals. Doing so will be vital to providing access to the American dream for future generations of responsible credit-worthy borrowers.

Appendix A: Summary of FHA Policy Changes Under the Current Administration

1. **Mortgage insurance premium (MIP) increases 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

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

4. 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 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 that was posted with the Mortgagee Letter
   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

5. 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. 1,780 lenders withdrawal from FHA's program as a result of violations of FHA approval, origination, or servicing requirements; and
      2. Imposition of more than $14.26 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. 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

6. 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

7. 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

8. 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

9. 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.

10. Reduction in allowable seller concessions

a. Proposed policy change published in June of 2010
   i. Received over 1,000 comments, prompting extensive additional analysis which led to substantial revisions to the rule
   ii. New proposed rule published February 23, 2012

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

12. Housing Counseling Certification

a. Published a Proposed Rule regarding new certification requirements for housing counselors
b. Home Owners Armed With Knowledge (HAWK)
    i. During 2013, two initiatives were launched by FHA that incorporated housing counseling into the lending and servicing process. HUD is closely monitoring both programs
c. Mortgagee Letter effective August 15, 2013 through September 30, 2016: Extenuating Circumstances/Back to Work
    i. Recognizes that millions of people lost jobs and homes during the recession
    ii. Since that time, many have become re-employed and are seeking to return to homeownership. However, the effect of bankruptcy, short sales or foreclosure can keep these families from purchasing a home for up to seven years. Under this policy, a household which had a negative economic event but now can demonstrate evidence of 12 months of on-time credit payments can be considered for an FHA loan if they complete housing counseling
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

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

Fiscal Year	Counts by Loan Purpose: Home Purchase	FHA Streamline Refinance	Other FHA Refinance	Conventional to-FHA Refinance	All Forward Loans	Volume ($ billions)
2000	839,869	34,443	6,780	32,007	913,099	94
2001	806,818	188,422	17,230	46,207	1,058,677	118
2002	862,898	318,245	28,525	64,475	1,274,143	148
2003	658,640	560,891	37,504	62,694	1,319,729	159
2004	586,110	291,483	26,147	56,695	960,435	116
2005	353,844	113,062	11,840	33,581	512,327	62
2006	313,998	36,374	14,722	60,397	425,491	55
2007	278,395	22,087	16,504	107,739	424,725	60
2008	631,655	66,772	28,510	360,456	1,087,393	181
2009	995,550	329,437	38,070	468,942	1,831,999	330
2010	1,109,580	212,896	39,596	305,537	1,667,609	298
2011	777,428	180,265	44,560	195,558	1,197,811	218
2012	733,863	274,061	47,593	129,223	1,184,740	213
2013	702,416	511,843	39,083	91,507	1,344,849	240
2014	594,997	115,038	20,959	55,359	786,353	135
2012Q1	176,168	36,657	11,230	31,852	255,907	45
2012Q2	166,168	62,179	13,376	36,615	278,338	50
2012Q3	193,557	70,389	14,036	38,078	316,060	58
2012Q4	197,970	104,836	8,951	22,678	334,435	61
2013Q1	177,852	142,365	10,154	22,757	353,128	64
2013Q2	157,439	156,020	11,467	25,429	350,355	64
2013Q3	181,297	140,372	10,534	24,177	356,380	63
2013Q4	185,828	73,086	6,928	19,144	284,986	49
2014Q1	152,965	35,909	5,003	14,611	208,488	36
2014Q2	119,832	26,405	4,796	13,457	164,490	28
2014Q3	148,017	26,881	5,159	13,576	193,633	33
2014Q4	174,183	25,843	6,001	13,715	219,742	38

NOTES: This table includes all single-family endorsements. There are a small number of loans today that are not obligations of the MMI Fund. Prior to FY 2009, two measurable programs, the 203(k) purchase-and-rehabilitation program, and the 234(c) condominium insurance, were not obligations of the MMI Fund. They are included here to provide a complete picture of FHA activity.

SOURCE: U.S. Department of HUD/FHA, November 2014.

Appendix C: Definitions and Clarifications

1. **Structure and operation of the MMIF.** The Mutual Mortgage Insurance (MMI) Fund operates with two primary sets of financial accounts.[17] First, all business transactions related to insurance operations are maintained in a series of Financing Accounts at the U.S. Treasury.[18] Then, secondary reserves for unexpected claim expenses are maintained in a separate Capital Reserve Account, which is also held at the U.S. Treasury. The Capital Reserve Account is unique to MMI Fund operations. It was established to assist in managing to the two-percent capital ratio requirement enacted by Congress in 1990. FHA's MMI Fund programs, however, like all federal government direct-loan and loan-guarantee programs, operate with what is called "permanent and indefinite budget authority." That provides access to the U.S. Treasury for any funds needed to pay extraordinary claim obligations. Thus, FHA programs are never in jeopardy of lacking sufficient funds to pay insurance claims. That would be true even in the absence of a Capital Reserve Account.

2. **Assessment of the Independent Actuary.** The National Housing Act requires that HUD contract for an independent actuarial study of the MMI Fund each year.[19] The two portfolios of the MMI 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 at www.hud.gov.[20]

   The actuarial studies use statistical models to develop 30-year projections of default, claim, loss-on-claim, and prepayment rates on current and future books of business. Those 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 home prices and interest rates to predict loan

[17] There are two additional sets of accounts that are independent of the insurance operations, and for which funds are directly appropriated by the Congress each year. The first is the set of Program Accounts which cover all personnel and administrative expenses for FHA operations. The other is the Liquidating Account, which represents remaining cash flows each year on pre-1992 insurance endorsements. The year 1992 marks implementation of the Federal Credit Reform Act of 1990 and introduction of the Financing Accounts.
[18] There are individual Financing Accounts maintained for each annual book of business, or what are called budget cohorts. There are also separate accounts for Forward loans and for HECM.
[19] See 12 USC 1708(a)(4).
[20] See http://www.hud.gov/offices/hsg/hsgrroom.cfm.

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, net present value (NPV) of cash flows was computed for each path. They were then 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" of the MMI Fund, which is defined by the National Housing Act as capital resources plus the present value of future cash flows of the MMI Fund.[21] The calculation of economic net worth 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 economic net worth on the updated portfolio at the end of each fiscal year.

Economic net worth 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. Economic net worth is the numerator of the statutory capital ratio measure. The denominator is the outstanding dollar volume of active insurance contracts.

[21] 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.