FHA Watch

July 2012
Volume 1, No. 7

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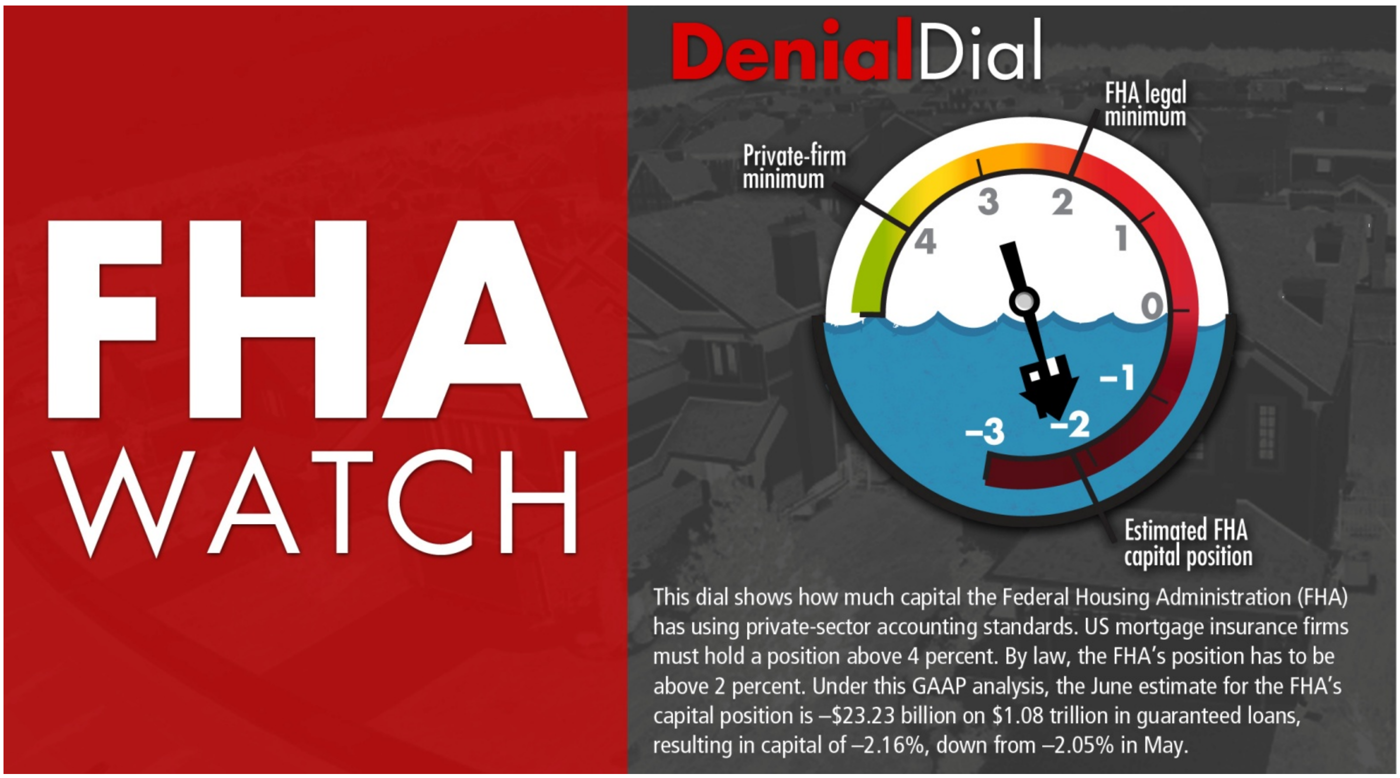

This Issue's Highlight

FHA's Financial Condition Worsens; Denial Dial Reset to Lowest Level Ever

One in six Federal Housing Administration (FHA) loans were delinquent in June as the total delinquency rate increased to 16.61 percent. This was due almost entirely to a jump in thirty- and sixty-day delinquencies. The serious delinquency rate ticked up to 9.48 percent.

The FHA's estimated net worth on a generally accepted accounting principles (GAAP) basis has declined by $6 billion since the end of FY 2011. In June, the FHA had an estimated current net worth of –$23.23 billion and a capital shortfall of $43–62 billion.

As a result, the Denial Dial has been reset to –2.16%, eclipsing the previous low set in January 2012.

This Month's Features

Note from the Editor: The July and August issues of *FHA Watch* will be limited to updating the monthly features only while we work on analyzing the impact of FHA lending practices on our communities.

Spotlight on Insolvency

FHA's Estimated Net Worth Continues Sharp Decline to –$23.23 Billion, with a Capital Shortfall of $43–62 Billion

The current estimate for the Federal Housing Administration (FHA)'s net worth is –$23.23 billion, down from –$16.95 billion and –$22.11 billion in September 2011 and May 2012, respectively. This is the result of an increase in the number of sixty-days-plus delinquent loans, continued monthly losses in excess of monthly cash flow, and a growing book of risk-in-force. The capital shortfall stands at $43 billion (using a 2 percent capital ratio) and $62 billion (using a 4 percent capital ratio).

Since September 30, 2011, *FHA Watch's* estimate of the FHA's current net worth, based on generally accepted accounting principles (GAAP), has decreased from –$17 billion to –$23 billion. Thus, with three-quarters of FY 2012 over, the FHA has lost $6 billion in net worth. This compares with the FHA's projection of an increase in capital of about $8 billion for all of FY 2012 using government accounting principles.

For the monthly data tabulation, see table A1 in the appendix.

Spotlight on Delinquency

One in Six FHA Loans Delinquent in June, and Serious Delinquency Rate Ticks Up to 9.48 Percent

One in six FHA loans are now delinquent, as delinquencies increased by nearly 37,000 loans from May, driving the rate 0.38 percent higher in June. The FHA's total delinquency rate was 16.61 percent in June, up from 16.23

percent in May 2012. An increase in thirty- and sixty-day delinquencies accounted for almost all the rise. Although some of this increase may be seasonal, the upward trend in thirty- and sixty-day delinquents will likely work to keep the FHA's serious delinquency rate elevated. The FHA's serious delinquency rate ticked up to 9.48 percent and remains at a near-record level, substantially higher than June 2011, when it stood at 8.34 percent.

For the monthly data tabulation, see table A2 in the appendix.

Spotlight on Best Price Execution

Government Mortgage Complex's Ginnie Brands Improve on Their Pricing Dominance over Fannie Mae

Table 1 demonstrates the pricing advantages the Ginnie/FHA, Ginnie/US Department of Agriculture (USDA), and Ginnie/US Department of Veterans Affairs (VA) divisions have over Fannie Mae. The FHA division had a better execution than Fannie on six out of ten representative loans, the USDA nine out of ten, and the VA on ten out of ten loans. And the greater the credit risk, the greater the advantage—Ginnie had an advantage of over $14,000 on the highest-risk loan shown (loan A guaranteed by the VA).

These results are slightly more favorable to the Ginnie brands than last month's, as the price spread with a Fannie thirty-year mortgage-backed security (MBS) widened by forty-one basis points, or about $628 per loan.

Table 1. Best Price Execution (Ginnie pricing advantages in bold)

Feature	Loan A	Loan B	Loan C	Loan D	Loan E	Loan F	Loan G	Loan H	Loan I	Loan J
MBS coupon	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	2.50%
Term	30-yr	30-yr	30-yr	30-yr	30-yr	30-yr	30-yr	30-yr	30-yr	15-yr
LTV	95.00%	96.50%	95%	90%	95%	90%	78%	78%	75%	78%
FICO	620	680	700	700	720	740	720	740	740	740
Risk level	Very high	High	Medium	Medium	Medium	Medium-low	Low	Low	Low	Very low
Ginnie/FHA Execution	97.98	97.75	97.98	97.98	97.98	97.98	103.38	103.38	103.38	102.88
Ginnie/USDA Execution	101.78	101.78	101.78	101.78	101.78	101.78	103.13	103.13	103.13	102.63
Ginnie/VA Execution	103.63	102.98	103.63	103.88	103.63	103.88	103.88	103.88	103.88	103.38
Fannie Execution	93.99	96.47	97.41	98.85	99.13	100.19	102.14	102.39	102.64	103.12
Ginnie/FHA advantage on a $150,000 loan compared to Fannie	**$5,972**	**$1,922**	**$842**	-$1,318	-$1,731	-$3,321	**$1,847**	**$1,472**	**$1,097**	-$366
Ginnie/USDA advantage on a $150,000 loan compared to Fannie	**$11,672**	**$7,959**	**$6,542**	**$4,382**	**$3,969**	**$2,379**	**$1,472**	**$1,097**	**$722**	-$741
Ginnie/VA advantage on a $150,000 loan compared to Fannie	**$14,447**	**$9,759**	**$9,317**	**$7,532**	**$6,744**	**$5,529**	**$2,597**	**$2,222**	**$1,847**	**$384**

Source: Adapted from JPMorgan's *2012 Securitized Products Outlook*, November 23, 2011, 18.
Note: Mortgage-backed security (MBS) pricing from *MBS Live*, published by Mortgage News Daily. Comparison based on MBS pricing as of July 13, 2012. On that date a Ginnie thirty-year MBS with a coupon of 3.0 percent had a price of 105.13, and a Fannie thirty-year MBS with the same 3.0 percent coupon had a price of 103.34. These prices were then adjusted for applicable borrower-paid credit fees and mortgage insurance premiums. Fannie's guarantee fee was increased by ten basis points in April 2012 as mandated by Congress. All publicly announced FHA premium increases are included. USDA and VA premiums are unchanged.

Each of the Government Mortgage Complex's five divisions has substantial pricing advantages over the private sector. The result is that the Government Mortgage Complex's share of the entire first-mortgage market continues to remain at around 90 percent.

The Road Map to FHA Reform

Specific Steps to Reform and the Status of Each

Below is a compendium of all of *FHA Watch's* suggested reforms. Each month, the "Road Map to Reform" will chronicle progress made in putting the FHA on a sustainable road to reform. There have been no status changes over the last month.

Table 2. Road Map to Program Reform

Principles for Program Reform:

1. Step back from markets that can be served by the private sector by taking steps to return to a traditional 10 percent home purchase market share.
2. Stop knowingly lending to people who cannot afford to repay their loans.
3. Help homeowners establish meaningful equity in their homes.
4. Concentrate on homebuyers who truly need help purchasing their first home.

Suggested Reforms to Implement Program Reform Principles 1–4	**Status (green denotes progress toward adoption, red denotes a step backward)**
Set loan limits equal to the county's current median house price.	In November 2011, Congress set higher limits.
Serve first-time homebuyers with incomes below the area median.	No action
Serve repeat homebuyers below 80 percent of area median.	No action
Set maximum FICO score at 675.	No action
Limit rate-reduction refinances to term reduction only; payment remains the same.	No action
Eliminate cash-out refinances.	No action
Eliminate specific risks that are difficult to offset with lower-risk features: 1. FICO scores below 580. 2. Adjustable rate mortgages. 3. Seller concessions greater than 3 percent.	1. Needs further action. In 2010, minimum down payment increased to 10 percent. 2. No action 3. Needs further action. In February 2012, the FHA issued a proposed rule that limits seller concessions to the greater of 3 percent or

	$6,000. This layering of risk leaves borrowers central to the FHA's low- and moderate-income mission prey to excessive default rates. The most common concession levels of 3, 4, and 5 percent experience 43, 64, and 96 percent higher failure rates, respectively, than loans with no seller concessions.
Limit/adjust risk layering to meet target projected average claim rates of 5 per 100 insured loans under normal circumstances and 10 per 100 insured loans under stress circumstances.	No action
Immediately reduce maximum claim coverage to 80 percent from the current 100 percent, with an ultimate goal of 50 percent.	No action
Require lenders to buy back any loan that defaults within six months of origination.	No action
Reinstate the use of an appraisal board. This would replace the current system where the lender chooses the appraiser.	No action
Require the FHA to make its data and actuarial analysis programs available publicly.	No action
Until the above reforms are implemented, levy a 0.25 percent, 0.50 percent, and 0.75 percent per-year government subsidy reduction fee on any Ginnie/FHA or Ginnie/USDA insured loan with an initial LTV of > 90 percent and <= 95 percent, with an initial LTV of > 80 percent and <= 90 percent, and with an initial LTV of <= 80 percent, respectively. Revenue would be paid directly to the Treasury and not benefit Ginnie, the FHA, or the USDA.	No action
Until the above reforms are implemented, the HUD Secretary should require FHA mortgagees to provide applicants for a forward FHA single-family loan with a clear and conspicuous notice within 72 hours of application and at closing setting forth the applicant's proposed LTV, FICO score, and total debt-to-income ratio, all as used in underwriting applicant's FHA loan. The notice should also	No action

provide the estimated cumulative claim rate for loans insured by the secretary and having similar risk characteristics to the applicant's. The secretary should make such estimate in a manner similar to that used in the FHA's annual actuarial study. The secretary should also disclose the average estimated cumulative claim rate for the most recent fiscal year as determined in the FHA's annual actuarial study.	

Table 3. Road Map to Fiscal Reform

Principles for Fiscal Reform:

1. Utilize generally accepted accounting principles, and set rigorous disclosure standards.
2. Establish and maintain loan loss and unearned premium reserves.
3. Establish and maintain a minimum capital requirement of 4 percent of amortized risk in force.
4. Fund a countercyclical premium reserve.

Suggested Reforms to Implement Fiscal Reform Principles 1, 2, 3, and 4	**Status (green denotes progress toward adoption, red denotes a step backward)**
Require use of generally accepted accounting standards applicable for private mortgage insurers with respect to quarterly examinations of the FHA's financial condition.	No action
Require application of US Securities and Exchange Commission disclosure standards to information disclosed regarding the FHA's insurance programs and funds.	This provision contained in the *FHA Emergency Solvency Act of 2012*, which passed the full House Financial Services Committee by voice vote on March 27, 2012.
Require the GAO to retain an independent third party to conduct a safety and soundness review under applicable generally accepted accounting principles applicable to the private sector and report within sixty days.	This provision contained in the *FHA Emergency Solvency Act of 2012.*
Require the FHA to establish an emergency capital plan with biweekly updates to Congress.	This provision contained in the *FHA Emergency Solvency Act of 2012.*
Require the FHA to establish and maintain loan loss and unearned premium reserves on a similar basis as applied to private mortgage insurers.	No action

Hold oversight hearings to determine the FHA's current and ongoing fiscal condition based on emergency capital plan reports.	No action
Require the maintenance of a minimum capital level of 4 percent calculated in accordance with generally accepted accounting principles as applied to private mortgage insurers.	No action
The FHA's premium structure should be set where 50 percent of the premium is sufficient to meet normal claim expectations on insured loans. Unused portions of this premium would accumulate in the capital reserve account. The remaining 50 percent of the premium would accumulate in a separate countercyclical catastrophic premium reserve account for a ten-year period and would be available to pay catastrophic losses from periodic but unpredictable general economic risks.	No action

Appendix: Historical Data Tables

Table A1. Insolvency Watch ($ Billions)

Date	FHA's "Capital Resources" (Assets)	Cash Flow since Sept. 30, 2011*	Estimated Loss Reserve (Liabilities on PMI Basis)**	Estimated Liability for Excess Upfront Premiums beyond GAAP Allowance	Current Net Worth (PMI Basis)	Required Capital Ratio	Required Capital Under Applicable Ratio***	Capital Shortfall (PMI Basis) ***
Sept. 30, 2011	$28.18	---	$37.13	$8.00	($16.95)	2%	$18.14	($35.09)
Sept. 30, 2011	$28.18	---	$37.13	$8.00	($16.95)	4%	$36.29	($53.24)
Dec. 31, 2011	$28.18	($0.43)	$41.09	$8.00	($21.34)	2%	$18.47	($39.81)
Dec. 31, 2011	$28.18	($0.43)	$41.09	$8.00	($21.34)	4%	$36.94	($58.27)
Jan. 31, 2012	$28.18	($0.21)	$41.74	$8.00	($21.78)	2%	$18.59	($40.37)
Jan. 31, 2012	$28.18	($0.21)	$41.74	$8.00	($21.78)	4%	$37.18	($58.96)
Feb. 29, 2012	$28.18	($0.60)	$40.27	$8.00	($20.69)	2%	$18.75	($39.44)
Feb. 29, 2012	$28.18	($0.60)	$40.27	$8.00	($20.69)	4%	$37.51	($58.19)
Mar. 31, 2012	$28.18	($0.98)	$38.68	$8.00	($19.48)	2%	$19.16	($38.64)
Mar. 31, 2012	$28.18	($0.98)	$38.68	$8.00	($19.48)	4%	$38.32	($57.80)
Apr. 30, 2012	$28.18	($1.37)	$40.17	$8.00	($21.36)	2%	$19.25	($40.61)
Apr. 30, 2012	$28.18	($1.37)	$40.17	$8.00	($21.36)	4%	$38.50	($59.87)
May 31, 2012	$28.18	($1.55)	$40.74	$8.00	($22.11)	2%	$19.36	($41.47)
May 31, 2012	$28.18	($1.55)	$40.74	$8.00	($22.11)	4%	$38.72	($60.83)
June 30, 2012	$28.18	($1.94)	$41.47	$8.00	($23.23)	2%	$19.32	($42.55)
June 30, 2012	$28.18	($1.94)	$41.47	$8.00	($23.23)	4%	$38.65	($61.88)

Notes: Table A1 estimates FHA's current net worth and capital shortfall under accounting rules applicable to a private mortgage insurer (PMI) such as Genworth. Estimates are based on Genworth having the FHA's delinquent loans, risk exposure, capital resources, and capital ratio (under both the 2 percent statutory requirement for the FHA and the 4 percent of risk-in-force requirement applicable to a PMI). In quarter 1 of 2012, Genworth had loss reserves equaling 60 percent of its risk-in-force on sixty-days-plus delinquent loans. This was up from 58 percent in quarter 4 of 2011. Genworth, Quarterly Financial Supplements, Delinquency Metrics-US Mortgage Insurance Segment, 50, http://phx.corporate-ir.net/phoenix.zhtml?c=175970&p=irol-quarterlyreports (accessed May 19, 2012).

*The FHA's negative cash flow was $143 million and $385 million per month during Q1 of FY 2012 and Q2 of FY 2012, respectively. See exhibit 10, US Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress*, 13. The FHA's forward single-family Mutual Mortgage Insurance Fund (MMIF) is expected to receive approximately $600 million from three settlements with lenders, which was added to January's cash flow. The MMIF received approximately $200 million from a settlement made with a lender in May 2012, which was added to May's cash flow. The FHA raised its upfront premium from 1 to 1.75 percent (excluding streamline refinances) effective for case numbers assigned on or after April 9, 2012. Since under GAAP accounting this amount would not be taken into income immediately, it will be accounted for in the "Estimated liability for excess upfront premiums beyond GAAP allowance." The amount of this liability was estimated at $8 billion as of May 31, 2012. This balance will be adjusted on a quarterly basis based on the FHA's Quarterly Report to Congress.

**Total based on the FHA's total amortized risk in force net of loans covered by loan loss reserve of $907.2 billion ($1.009 trillion − $101.8 billion) and $966 billion ($1.076 trillion − $110 billion) as of September 30, 2011, and June 30, 2012 (estimated), respectively. See exhibit II-2 in US Department of Housing and Urban Development, *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2011* (excludes HECM) (Washington, DC: Author, October 12, 2011), 14; US Department of Housing and Urban Development, *Monthly Report to the FHA Commissioner*, May 2012, 6, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/com/commenu (accessed July 14, 2012); and US Department of Housing and Urban Development, *FHA Outlook*, March 2012, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/ooe/olmenu (accessed May 19, 2012). Outstanding balance of loans sixty-days-plus delinquent at June 30, 2012, and September 30, 2011, based on loan counts of 867,959 and 803,899, respectively, and an average loan balance for loans going to claim of $126,524.

*****All months have been updated to take this additional feature into account.

Table A2. National Delinquency Watch

End Date	Thirty-Days Delinquency Rate and Number of Loans	Sixty-Days-Plus Delinquency Rate and Number of Loans	Thirty-Days-Plus Delinquency Rate and Number of Loans	Serious Delinquency Rate and Number of Loans	Total Loans
Jan. 2011	N/A	N/A	N/A	8.9% / 612,443	6,882,984
Feb. 2011	N/A	N/A	N/A	8.9% / 619,712	6,932,510
Mar. 2011	N/A	N/A	N/A	8.3% / 580,480	6,983,893
Apr. 2011	N/A	N/A	N/A	8.2% / 575,950	7,035,016
May 2011	N/A	N/A	N/A	8.2% / 578,933	7,090,489
June 2011	5.79% / 411,258	10.55% / 749,204	16.62% / 1,160,462	8.34% / 592,366	7,103,531
Sept. 2011	5.70% / 413,834	11.08% / 803,899	16.78% / 1,217,733	8.77% / 636,778	7,258,328
Oct. 2011	5.55% / 404,773	11.47% / 836,789	17.02% / 1,241,562	9.05% / 660,499	7,296,639
Nov. 2011	5.61% / 411.663	11.81% / 865,658	17.42% / 1,277,321	9.46% / 693,314	7,331,525
Dec. 2011	5.72% / 421,404	12.07% / 889,602	17.79% / 1,311,006	9.73% / 716,786	7,370,426
Jan. 2012	5.35% / 397,018	12.18% / 903,748	17.53% / 1,300,766	9.92% / 735,760	7,418,830
Feb. 2012	4.78% / 355,092	11.70% / 871.870	16.47% / 1,226,962	9.73% / 725,002	7,450,480
Mar. 2012	4.57% / 341,213	11.21% / 837,472	15.78% / 1,178,685	9.47% / 707,930	7,471,708
Apr. 2012	4.77% / 358,174	11.20% / 840,803	15.97% / 1,198,977	9.42% / 707,222	7,507,031
May 2012	4.93% / 372,514	11.29% / 852,608	16.23% / 1,225,222	9.43% / 711,612	7,549,730
June 2012	5.19% / 393,894	11.43% / 867,959	16.61% / 1,261,853	9.48% / 719,984	7,594,689

Source: US Department of Housing and Urban Development, "Neighborhood Watch," https://entp.hud.gov/sfnw/public (Servicing download, Excel; accessed June 14, 2012) and US Department of Housing and Urban Development, "FHA Outlook," http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/ooe/olmenu (accessed April 14, 2012). Rates not seasonally adjusted. Serious delinquency includes ninety-days-plus delinquency and loans in bankruptcy or foreclosure.