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HUD Secretary, FHA Commissioner Report on FHA's Finances

Annual Actuarial Study Shows Capital Reserve Ratio Below Mandated Level; FHA Credit Policy Reforms Expected to Address Risk, Raise Reserve Levels

(Washington, DC) – U.S. Department of Housing and Urban Development (HUD) Secretary Shaun Donovan and Federal Housing Administration (FHA) Commissioner David H. Stevens today briefed members of the media, industry leaders and congressional Members on the FHA's financial outlook, in coordination with the agency's release of its annual independent actuarial study. The independent study shows that FHA has sustained significant losses from loans made before 2009, and the capital reserve ratio has fallen below the congressionally mandated threshold, but concludes that under most economic scenarios considered FHA's reserves would remain above zero.

FHA's capital reserve ratio, which is determined through findings from the independent actuarial study, measures reserves held in excess of those needed to cover projected losses over the next 30 years. The review projects the capital reserve ratio to be 0.53 percent of total insurance in force this year, below the two-percent statutory threshold. This capital ratio fell from 3 percent in the fall of 2008, reflecting difficult conditions in the housing market. The 0.53 percent capital ratio (which represents the funds held in the Capital Reserve Account) is in addition to the auditor's base case estimate of the 30-year reserves needed to pay for losses on existing loans (which are held in the Financing Account). Combining those two accounts, FHA holds $31 billion in its total reserves today, or more than 4.5 percent of total insurance-in-force.

After a record drop in the housing market, the FHA is now helping to facilitate the market's recovery. The volume of FHA insurance guarantees has increased since 2008, as private sources of mortgage finance have retreated from the market. Nearly 80 percent of FHA's purchase-loan borrowers in 2009 were first-time homebuyers. In the second quarter of 2009, nearly 50 percent of all first-time buyers in the entire housing market used FHA-insured loans. The new lending is being done as FHA has halted the seller-financed down payment assistance program, tightened underwriting standards on streamline refinances, increased oversight of lenders, and is considering additional prudent measures. The quality of new loans insured by

FHA has improved on several metrics including average borrower credit score; the average borrower FICO score today is 693 compared to 633 two years ago. Additionally, FHA insured more than 835,000 refinances in FY 2009 to lower interest rate loans, enabling borrowers to save an estimated total annual savings of $1.3 billion.

“FHA is playing a critical role in restoring health to the housing market by helping working families access mortgage finance when private capital is tight,” said Secretary Donovan. “This is a temporary role which FHA has played in previous economic downturns. The Administration is committed to ensuring that the FHA steps back as private capital returns to the market. With this temporary increased role comes increased risk and responsibility. That’s why we are committed to closely monitoring market behavior patterns and economic risks so that we are prepared to enact reforms that ensure the FHA’s financial health moving forward.”

“There are real risks to the FHA and we are aggressively addressing those real risks with real reforms,” Commissioner Stevens said. “FHA will not tolerate fraudulent or predatory lending practices and we have enforced tighter standards and taken action against lenders who violate FHA origination and underwriting requirements, starting with the suspension of Taylor, Bean and Whitaker and most recently, actions against Lend America. The FHA has also implemented several reforms to strengthen its credit policies, which will ultimately help shore up the reserves and reduce risk.”

Today, Donovan and Stevens also introduced Robert Ryan as the agency’s new Chief Risk Officer, the first-ever in the FHA’s history. As Chief Risk Officer, Ryan will oversee the coordination of FHA’s efforts to concentrate risk management in a single division devoted solely to managing and mitigating risk to the FHA’s insurance fund – across all FHA programs.

As part of its efforts to manage risk, FHA is modeling more extreme scenarios than those used by the actuary, including scenarios showing the reserves going below zero. FHA is committed not only to understanding its risks, but also to developing policy responses appropriate to addressing that risk. As an important step in that effort, in September, Stevens announced plans to implement the following set of credit policy changes to enhance the agency’s risk management functions:

Changes Enacted via Mortgagee Letter, Effective January 1, 2010

- Require Submission of Audited Financial Statements by Supervised Mortgagees
- Modify Procedures for Streamline Refinance Transactions
- Require Appraiser Independence in Loan Origination
- Modify Appraisal Validity Period
- Enable Appraisal Portability

Changes Being Pursued by Rule Making Process

- Modify Mortgagee Approval and Participation in FHA Loan Origination
- Increase Net Worth Requirements for Mortgagees

The FHA’s independent actuarial study and HUD’s report to Congress are available on HUD’s website, www.hud.gov.