FHA Single-Family Mortgage Insurance: Financial Status of the Mutual Mortgage Insurance Fund (MMI Fund)

Katie Jones
Analyst in Housing Policy

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Summary

The Federal Housing Administration (FHA) insures private lenders against losses on home mortgages that meet certain eligibility criteria. If the mortgage borrower defaults (that is, does not repay the mortgage as promised) and the home goes to foreclosure, FHA pays the lender the remaining principal amount owed. By insuring lenders against the possibility of borrower default, FHA is intended to expand access to mortgage credit to some households who might not otherwise be able to obtain affordable mortgages, such as those with small down payments.

When an FHA-insured mortgage goes to foreclosure, the lender files a claim with FHA for the remaining amount owed on the mortgage. Claims on FHA-insured home mortgages are paid out of the Mutual Mortgage Insurance Fund (MMI Fund), which is funded through fees paid by borrowers (called premiums), rather than through appropriations. However, like all federal credit programs covered by the Federal Credit Reform Act of 1990, FHA can draw on permanent and indefinite budget authority with the U.S. Treasury to cover unanticipated increases in the cost of the loans that it insures, if necessary, without additional congressional action.

Each year, as part of the annual budget process, the expected costs of mortgages insured in past years are re-estimated to take into account updated information on loan performance and economic assumptions. If the anticipated costs of insured mortgages have increased, then FHA must transfer funds from a secondary reserve account into its primary reserve account to cover the amount of the increase in the anticipated cost of insured loans. If there are not enough funds in the secondary reserve account, then the MMI Fund is required to take funds from Treasury using its permanent and indefinite budget authority in order to make the required transfer.

Separately from the budget re-estimates, FHA is required by law to obtain an independent actuarial review of the MMI Fund each year. This review provides a view of the MMI Fund's financial status by estimating the MMI Fund's economic value—that is, the amount of funds that the MMI Fund currently has on hand plus the net present value of all of the expected future cash flows on the mortgages that are currently insured under the MMI Fund. The actuarial review is used to determine whether the MMI Fund is in compliance with a statutory requirement to maintain a capital ratio of at least 2%. The capital ratio is the economic value of the MMI Fund divided by the total dollar amount of mortgages insured under the MMI Fund.

In the years following the housing and mortgage market turmoil that began around 2007, increased foreclosure rates, as well as economic factors such as falling house prices, contributed to increases in expected losses on FHA-insured loans. This put pressure on the MMI Fund and reduced the amount of resources that FHA had available to pay for additional, unexpected future losses. The capital ratio fell below 2% in FY2009 and remained below 2% for several years thereafter, turning negative in FY2012 and FY2013. Concerns about FHA's finances culminated at the end of FY2013, when FHA announced that it would need $1.7 billion from Treasury to cover an increase in anticipated costs of insured loans. This marked the first time that FHA needed funds from Treasury to make the required transfer of funds between the primary and secondary reserve accounts.

More recently, the financial position of the MMI Fund has improved. The capital ratio again exceeded the 2% threshold in FY2015 and has remained above 2% in the years since. The FY2018 actuarial review of the MMI Fund estimated the economic value of the MMI Fund to be positive $34.9 billion and the capital ratio to be 2.76%. This suggests that the MMI Fund would have about $34.9 billion remaining after realizing all of its expected future cash flows on currently insured mortgages. The FY2018 results represent an increase from FY2017, when the capital ratio was estimated to be 2.18% and the economic value was estimated to be $26.7 billion.

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Introduction

The Federal Housing Administration (FHA) was established by the National Housing Act of 1934 and became part of the Department of Housing and Urban Development (HUD) in 1965. It insures private lenders against losses on certain home mortgages.[1] If the borrower does not repay the mortgage and the home goes to foreclosure, FHA pays the lender the remaining amount that the borrower owes (that is, it pays a claim to the lender). FHA charges borrowers fees, called premiums, in exchange for the insurance.

FHA insurance is intended to encourage lenders to offer mortgages to some borrowers who otherwise might be unable to access mortgage credit at affordable interest rates or at all. For example, FHA requires a smaller down payment than many other types of mortgages, potentially making it easier for lower-wealth borrowers, first-time homebuyers, or others for whom a large down payment may present a barrier to homeownership to obtain a mortgage. To qualify for FHA insurance, both the borrower and the mortgage must meet certain criteria.[2] For example, the principal balance of the mortgage must be under a certain dollar threshold. Lenders that originate FHA-insured mortgages must be approved by FHA.

This report describes certain measures of the financial health of the FHA insurance fund for home mortgages, the Mutual Mortgage Insurance Fund. The discussion in this report assumes a certain degree of familiarity with FHA-insured mortgages. For more information on the basic features of FHA-insured mortgages and FHA's role in the mortgage market, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview*.

The Mutual Mortgage Insurance Fund

Most single-family mortgages insured by FHA are financed through an insurance fund called the Mutual Mortgage Insurance Fund (MMI Fund).[3] Since FY2009, the MMI Fund has included FHA-insured reverse mortgages as well as traditional "forward" home mortgages.[4] Much of the discussion in this report focuses only on traditional forward mortgages, rather than reverse mortgages. However, certain specified sections discuss both forward and reverse mortgages.

Money flows into the MMI Fund primarily from the mortgage insurance premiums paid by borrowers and from sales of foreclosed properties, and money flows out of the MMI Fund primarily from claims paid to lenders when FHA-insured mortgages default. The MMI Fund is

[1] The National Housing Act has been amended a number of times to allow FHA to insure a wider variety of mortgages than just mortgages on single-family homes, including mortgages on multifamily buildings, hospitals, and other health care facilities. This report focuses only on FHA's single-family program.

[2] The basic features of FHA-insured mortgages are described in CRS Report RS20530, *FHA-Insured Home Loans: An Overview*. For detailed underwriting requirements for FHA-insured mortgages, see HUD Handbook 4000.1, *FHA Single Family Housing Policy Handbook*, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh.

[3] Single-family mortgages are defined as mortgages on properties with one to four dwelling units. For example, a duplex would be considered a single-family property under this definition. Some small FHA single-family mortgage programs, such as mortgages for property improvements and certain mortgages on manufactured homes, are insured under a different FHA insurance fund.

[4] Reverse mortgages allow elderly homeowners to access the equity in their homes. The lender makes payments to the borrower, and is repaid with the proceeds from the sale of the home when the homeowner dies or chooses to no longer occupy the property. FHA-insured reverse mortgages are called Home Equity Conversion Mortgages (HECMs). For more information on HECMs, see CRS Report R44128, *HUD's Reverse Mortgage Insurance Program: Home Equity Conversion Mortgages*, by Libby Perl.

intended to be self-supporting. It is meant to pay for costs related to insured loans (such as insurance claims paid to lenders) with money it earns on those loans (such as through premiums paid by borrowers), not through appropriations.[5]

The MMI Fund is also required to maintain a capital ratio of 2% to help pay for any unexpected increases in losses on its insured mortgages, beyond the losses that it currently anticipates. (Capital in this context is defined as the assets that the MMI Fund currently has on hand, plus the net present value of future cash flows associated with the mortgages that it currently insures. The capital ratio is the ratio of capital to the total dollar amount of mortgages insured under the MMI Fund.) As will be discussed in more detail later in this report, the MMI Fund, like all federal loan and loan guarantee programs subject to the Federal Credit Reform Act of 1990, has permanent and indefinite budget authority to receive funds from the Department of the Treasury to cover increases in the costs of loan guarantees made in prior years.

FHA faces an inherent tension between facilitating the provision of mortgage credit to underserved borrowers and safeguarding the health of the MMI Fund. In the years following the housing and mortgage market turmoil that began around 2007, rising mortgage default rates and falling home prices put pressure on the MMI Fund. This resulted in the capital ratio falling below the required 2% threshold in FY2009 and then turning negative for a period of time. The capital ratio became positive again in FY2014 and regained the 2% threshold in FY2015.

The capital ratio falling below 2%, and then turning negative, raised concerns that the MMI Fund would not have enough money to cover all of its expected future losses on the loans that it was currently insuring. At the end of FY2013, the MMI Fund received $1.7 billion from Treasury using its permanent and indefinite budget authority to ensure that it was holding enough funds to cover expected future losses on insured loans. This represented the first time that the MMI Fund ever had to draw on its permanent and indefinite budget authority with Treasury for this purpose. The MMI Fund has not needed to draw such funds from Treasury in subsequent years.

Congress has expressed ongoing interest in the MMI Fund's financial status and its prospects for needing additional funds to pay for future losses on its insured loans. This report focuses on the financial position of the MMI Fund. It begins with a brief overview of some of the major factors that affect the MMI Fund's financial soundness. The remainder of the report focuses on (1) how the MMI Fund is accounted for in the federal budget and (2) the results of annual independent actuarial reviews that are mandated by Congress. The budgetary treatment of FHA-insured mortgages and the actuarial review are two different processes, but both examine how the loans insured under the MMI Fund have performed and are expected to perform in the future and the effect of this loan performance on the financial position of the MMI Fund. The annual actuarial review is the basis for determining the capital ratio. However, it is the annual budget process that determines whether or not the MMI Fund requires assistance from Treasury.

Major Factors Affecting the Stability of the MMI Fund

This section briefly describes some of the major factors that can affect the MMI Fund's financial position. These factors include default and foreclosure rates on FHA-insured loans and the average loss to FHA when a loan goes to foreclosure, the amount of the premiums charged by FHA, the volume of loans that FHA insures, and current and future economic conditions.

[5] FHA does receive appropriations to pay for staff salaries and administrative contract expenses.

Foreclosures and Associated Loss Severities

Traditionally, when an FHA-insured mortgage goes to foreclosure, FHA pays the lender the remaining amount that the borrower owes on the mortgage and takes ownership of the property.[6] The payment to the lender is called a claim. The loss to FHA is the claim amount paid plus any other foreclosure-related expenses (such as the cost of maintaining the foreclosed property), minus any amount that FHA can recoup by selling the foreclosed home. FHA's total losses related to defaults and foreclosures can depend on, among other factors, (1) the number of delinquencies, defaults, and foreclosures on FHA-insured loans; (2) the success of efforts to help borrowers avoid foreclosure on FHA-insured loans or to minimize the costs to FHA associated with a foreclosure; and (3) how much FHA can recoup by reselling foreclosed homes.

Number of Mortgage Delinquencies and Foreclosures

The number of FHA-insured mortgages that become delinquent on mortgage payments impacts FHA's financial status because higher numbers of delinquencies are likely to translate into higher numbers of foreclosures and more claims paid out by FHA. Not all delinquent or defaulted mortgages will necessarily result in completed foreclosures, but higher delinquency and default rates are more likely to lead to higher foreclosure rates.

During turmoil in the housing and mortgage markets starting around 2007, delinquency and foreclosure rates on all types of mortgages, including FHA-insured mortgages, increased, with FHA "serious delinquency" rates peaking in early 2012 at nearly 10%.[7] (Seriously delinquent loans are generally defined as loans that are 90 or more days past due, in the foreclosure process, or in bankruptcy.) This increase in distressed mortgages put pressure on the MMI Fund. More recently, delinquency rates on FHA-insured mortgages have generally improved. As of December 2018, FHA reported that about 4% of its insured loans were seriously delinquent.[8]

A number of factors contributed to elevated delinquency and default rates on FHA-insured mortgages in the aftermath of the housing market turmoil. Unfavorable economic conditions, such as decreases in home prices and increases in unemployment, affected many regions of the country, leading to more defaults and foreclosures on FHA-insured loans. Other factors, such as the credit quality of some loans, also contributed to increased default rates. Similarly, many factors contributed to the improvement in loan performance beginning in 2013. These factors included improving economic conditions and better credit quality of newly insured loans. FHA data show that the loans insured by FHA in the years since 2009 have generally performed better to date than the loans insured in the years immediately preceding 2009, based on a comparison of serious delinquency rates at the same number of months after loan origination.[9]

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[6] In recent years, FHA has increasingly been pursuing alternatives to this traditional method of taking ownership of the foreclosed property. Such alternatives include selling distressed mortgage notes prior to foreclosure; sales of properties to third parties at foreclosure auctions rather than the property being conveyed to HUD; and increasing use of short sales, which are described in footnote 12.

[7] 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 2018*, November 15, 2018, pp. 37 and 107-108, https://www.hud.gov/sites/dfiles/Housing/documents/2018fhaannualreportMMIFund.pdf.

[8] U.S. Department of Housing and Urban Development, *FHA Single Family Loan Performance Trends*, December 2018, p. 2, https://www.hud.gov/sites/dfiles/Housing/documents/FHALPT_Dec2018.pdf.

[9] U.S. Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress, FY2018 Q4*, p. 15, https://www.hud.gov/sites/dfiles/Housing/documents/MMIQtrlyQ42018.pdf.

Loss Mitigation Efforts

Default and foreclosure rates can be affected by efforts to help borrowers avoid foreclosure, such as by offering mortgage modifications. Efforts to help borrowers avoid foreclosure and thereby mitigate the losses that the MMI Fund would experience due to a foreclosure are referred to as loss mitigation actions. When a borrower with an FHA-insured loan defaults, the servicer of the loan is required to evaluate whether the borrower is eligible for certain specified loss mitigation actions.[10] If successful, these options can reduce the losses that FHA would otherwise bear on a troubled loan and help minimize losses to the MMI Fund. Some loss mitigation options are intended to result in a borrower keeping his or her home, such as loan forbearance or loan modifications.[11] Other options will result in the borrower losing his or her home, but avoiding foreclosure, such as short sales and deeds-in-lieu of foreclosure.[12]

FHA pays incentive payments and, in some cases, partial insurance claim payments to lenders in connection with loss mitigation actions. These costs are likely to be less to FHA than the cost of paying a claim after a foreclosure. However, if the borrower defaults on the mortgage again in the future and the loan then goes to foreclosure, FHA could end up paying the full claim amount. Therefore, the extent to which loss mitigation actions minimize losses to FHA will depend on whether borrowers who receive any type of loan workout remain current on their mortgages or default again in the future.

Loss Severity Rates

If a mortgage must ultimately go to foreclosure, FHA may be able to recoup some of the claim amount that it pays to the lender by selling the property. In general, the amount that it recoups will usually be less than the claim amount. FHA also incurs costs related to managing and marketing foreclosed properties before they are ultimately sold. The amount of money that FHA loses on a given claim as a share of the outstanding loan balance, after accounting for any amounts it recoups from selling the property, is referred to as its loss severity rate.

For the fourth quarter of FY2018, FHA reported that, on average, it lost about 41% of the unpaid principal balance of the loan when it paid insurance claims. (These rates can vary from quarter to quarter; for example, in FY2018 loss severity rates ranged from about 41% to about 46%; in FY2017 they ranged from about 46% to 54%.) FHA's loss severity rates have generally improved in recent years. For example, loss severity rates were 55% in the fourth quarter of FY2013 and

[10] FHA's loss mitigation policies are described in Section III.A.2 of HUD Handbook 4000.1, *FHA Single-Family Housing Policy Handbook*, http://portal.hud.gov/hudportal/documents/huddoc?id=40001HSGH.pdf.

[11] Specific loss mitigation options include forbearance agreements, partial claims, and the FHA-Home Affordable Modification Program (FHA-HAMP). Forbearance agreements allow a borrower to make lower mortgage payments for a specified period of time, and to repay the difference between the lower mortgage payment and the actual amount owed at a later date. Partial claims allow a borrower to become current again on a delinquent mortgage through an advance of funds from the lender on the borrower's behalf to reinstate the mortgage. FHA pays the lender for this advance of funds—called a partial claim, because the amount paid by FHA is only part of what the full claim amount would be if the loan went through foreclosure—and the borrower repays FHA in the future. FHA-HAMP essentially combines a loan modification and a partial claim to modify a borrower's loan to achieve an affordable payment. The option was created to parallel the broader Home Affordable Modification Program (HAMP), a temporary foreclosure prevention program that was created in 2009 and ended in 2016, but it differs in some important ways from HAMP.

[12] Short sales allow a borrower to sell the home for less than the full amount owed on the mortgage, and the lender accepts the proceeds of the sale as payment in full. A deed-in-lieu of foreclosure allows the borrower to surrender the deed to the property as payment in full on the mortgage. For more information on requirements governing FHA short sales (referred to as pre-foreclosure sales) and deeds-in-lieu of foreclosure, see HUD Handbook 4000.1, *FHA Single Family Housing Policy Handbook*, https://www.hud.gov/sites/documents/40001HSGH.PDF, beginning on p. 640.

61% in the fourth quarter of FY2012, compared to about 41% in the fourth quarter of FY2018.[13] This improvement has been driven in part by increased use of alternative methods of selling foreclosed properties, which have generally had lower loss severity rates than traditional foreclosures.[14] However, the loss severity rates for traditional foreclosures have also decreased somewhat over time. A number of factors other than disposition methods can also affect loss severities, including home price appreciation or depreciation and the characteristics of the mortgages and properties in question.

Mortgage Insurance Premiums

FHA charges fees, or premiums, to borrowers who obtain FHA-insured mortgages. These premiums are intended to cover the costs of any claims that are paid out of the MMI Fund. Borrowers pay both an up-front premium and an annual premium. These fees represent the main source of revenue flowing into the MMI Fund.

The amount of premium revenue that comes into the MMI Fund depends on a number of factors, including the amount of the premiums charged, the number and dollar amount of outstanding mortgages on which borrowers are paying premiums, and how many of these outstanding mortgages are ultimately prepaid—through refinancing the mortgage, paying off the loan, or going to foreclosure—resulting in the borrower no longer paying premiums. Raising premiums can bring more money into the insurance fund and help to ensure that FHA is pricing its insurance high enough to adequately cover its risks. However, if premiums are raised too high, fewer borrowers might choose to take out FHA-insured mortgages, potentially affecting the overall amount of premium revenue that FHA earns. Furthermore, raising premiums too high could reduce the overall quality of the mortgages that FHA insures by potentially making FHA-insured mortgages a less attractive option for all but the borrowers who present the largest credit risk.

FHA raised the annual premiums that it charges multiple times in the years following the housing market turmoil before announcing a decrease in the annual premium in January 2015.[15] The annual premiums that FHA is currently charging are lower than at any time since October 2010, though they are higher than the premiums that were charged prior to that date.[16]

Loan Volume

The number and dollar volume of loans that FHA insures plays a role in its economic stability. On the one hand, more loans insured by FHA could lead to more premium revenue coming into the MMI Fund as more borrowers pay premiums on their FHA-insured loans. On the other hand, more mortgages insured by FHA also increases FHA's liability for loan defaults. Ultimately, the

[13] U.S. Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress, 2018 Q4*, p. 23, and *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress, 2017 Q4*, p. 22, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.

[14] Alternative disposition methods include short sales, bulk sales of severely delinquent loans prior to foreclosures being completed, and selling foreclosed properties directly to third parties at a foreclosure auction rather than conveying the properties to HUD.

[15] In early January 2017, during the final weeks of the Obama Administration, FHA announced that it planned a further decrease in the annual mortgage insurance premiums. However, later in January, the Trump Administration suspended the planned premium decrease before it had gone into effect, citing a need to further study the potential impact of a premium decrease. See FHA Mortgagee Letters 2017-01 and 2017-07, https://www.hud.gov/program_offices/administration/hudclips/letters/mortgagee.

[16] For more information on FHA's mortgage insurance premiums, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview*.

quality of the loans insured and their future performance influence the overall impact of loan volume on the financial stability of the MMI Fund.

Economic Conditions and Projections

Economic and housing market conditions impact FHA's financial position in several ways. First of all, economic conditions can contribute to default and foreclosure rates. If more people become unemployed or underemployed, or if home prices fall such that people cannot sell their homes if they can no longer afford their mortgages, then more people may face default or foreclosure. Falling house prices also limit the amount that FHA can recoup when it sells a foreclosed property.

Projections of future economic conditions are also important factors in evaluating the health of the MMI Fund. The expected future paths of house prices and interest rates, in particular, play large roles in estimating how FHA-insured mortgages will perform in the future and, ultimately, how much money is expected to flow into and out of the MMI Fund. The future path of house prices is important because, as noted, house prices play a role in default and foreclosure rates and in how much FHA can recoup on foreclosures. Interest rates are important because they can affect home purchase activity as well as the decision by homeowners to refinance their mortgages, which affects how much premium revenue FHA expects to earn as well as affecting FHA's potential liability for future claims. If borrowers with FHA-insured mortgages refinance into new mortgages that are not insured by FHA, those borrowers will stop paying premiums to FHA, reducing the amount of revenue that FHA takes in. However, FHA's overall liabilities will also be reduced since it will no longer be responsible for repaying the lender if the borrower defaults on the mortgage.

If assumptions about future economic conditions and their impact on loan performance are not accurate, then current estimates of the MMI Fund's financial position may also not be accurate.

The MMI Fund in the Federal Budget

This section describes how FHA-insured mortgages are accounted for in the federal budget in the year that the loans are insured and in the years thereafter. It includes a discussion of the circumstances under which the MMI Fund would need an appropriation in order to cover the cost of insuring new single-family loans in an upcoming fiscal year (a situation which has never occurred), and the circumstances under which the MMI Fund can draw on permanent and indefinite budget authority with Treasury to reserve for higher-than-expected costs of loans insured in past years (an event that occurred at the end of FY2013).

Credit Reform Accounting and Credit Subsidy Rates

The Federal Credit Reform Act of 1990 (FCRA) specifies the way in which the costs of federal loan guarantees, including FHA-insured loans, are recorded in the federal budget.[17] The FCRA requires that the estimated lifetime cost of guaranteed loans (in net present value terms) be recorded in the federal budget in the year that the loans are insured. The lifetime cost per dollar of loans guaranteed is reflected in the budget as a *credit subsidy rate*, and the credit subsidy rate

[17] For more information on how the costs of federal credit programs are treated in the federal budget, see archived CRS Report R42632, *Budgetary Treatment of Federal Credit (Direct Loans and Loan Guarantees): Concepts, History, and Issues for Congress*.

multiplied by the total dollar volume of loans insured that year results in the total amount of credit subsidy for those loans.[18]

When a loan guarantee program is estimated to have a positive credit subsidy rate, it requires an appropriation to cover the cost of new loan guarantees before it can insure any new loans in that fiscal year. When a loan guarantee program is estimated to have a negative credit subsidy rate, it means that the present value of the lifetime cash flows associated with the guaranteed loans is expected to result in more money coming into the account than flowing out if it. Rather than requiring an appropriation, a negative credit subsidy rate generates negative subsidy, resulting in *offsetting receipts.* In the case of the MMI Fund, these offsetting receipts can offset other costs of the HUD budget.[19]

In accordance with the FCRA, each year as part of the President's budget request, FHA and the Office of Management and Budget (OMB) estimate the credit subsidy rate for the loans expected to be insured in the upcoming fiscal year.[20] These estimates are based on factors such as projections of how much mortgage insurance premium revenue the loans insured in the upcoming year are expected to bring in, projections of how much FHA will have to pay in future insurance claims related to those loans, and projections of how much money FHA will be able to recover by selling foreclosed properties. These projections, in turn, rest on assumptions about the credit quality of the loans being made and assumptions about future economic conditions (including house prices and interest rates).

Since credit reform accounting was implemented, FHA's single-family mortgages have always been estimated to have *negative* credit subsidy in the year that they are insured.[21] That is, over the life of the loans, the insured loans are projected to make money for the government rather than require an appropriation from the government to pay for their costs. (This applies only to the costs associated with the insured loans themselves; credit subsidy rates do not include the administrative costs of a program. FHA does receive appropriations for administrative contract expenses and for salaries.[22]) The original credit subsidy rate estimates for FHA-insured loans

[18] In technical terms, a credit subsidy rate is calculated as the net present value of expected future cash flows from mortgages insured in a given year, divided by the dollar volume of loans expected to be insured in that year. The "net present value of expected future cash flows" is the present value of expected cash flows out of the insurance fund (such as claims expected to be paid in the future on defaulted mortgages) net of expected cash flows into the insurance fund (such as premiums expected to be paid by borrowers).

[19] For more information on recent trends in FHA offsetting receipts and their role in the budget process, see CRS Report R42542, *Department of Housing and Urban Development (HUD): Funding Trends Since FY2002*.

[20] FHA, in conjunction with OMB, estimates the expected gain or cost of insuring mortgages during the fiscal year in the President's annual budget requests. The Congressional Budget Office (CBO) calculates its own estimate of the expected gains or costs using its own models and assumptions. The CBO numbers are the ones that are used in the appropriations process, including determining whether the FHA single-family mortgage insurance program will require an appropriation and determining the amount of any offsetting receipts.

[21] While FHA's traditional single-family mortgage program has always been estimated to have a negative credit subsidy rate in the year that the loans are insured, other FHA programs have at times been estimated to have positive credit subsidy rates. When this occurs, appropriations must be provided in order for FHA to enter into new commitments to insure loans under those programs in those fiscal years.

[22] In FY2018, FHA received an appropriation of $130 million for administrative contract expenses for all of its programs, including multifamily and healthcare facilities programs. Funding for salaries is appropriated as part of HUD's overall appropriation for salaries and expenses. Annual appropriations laws also provide FHA with the authority to enter into commitments to insure loans (called commitment authority), allowing FHA to insure up to a certain maximum dollar volume of loans. In FY2018, Congress authorized FHA to insure up to a total of $400 billion in mortgages under the MMI Fund.

have ranged from a low of -0.05% in FY2009 to a high of -9.03% in FY2015.[23] The total amount of money that FHA would expect to earn on loans insured in a given year depends on the total dollar amount of loans it insures in that year as well as the credit subsidy rate.

If FHA's single-family program were ever estimated to have a positive credit subsidy rate for the upcoming fiscal year, it would require an appropriation to cover the difference between the amount of money FHA expected to take in and pay out over the life of the loans. If funding was not appropriated to cover a positive subsidy rate, then FHA would not be able to insure new loans in that year. (For a brief discussion of a proposed change in the required method of calculating credit subsidy rates that could result in the MMI Fund having a positive credit subsidy rate, see the nearby text box, "FHA and "Fair Value" Accounting.")

FHA and "Fair Value" Accounting

FHA's credit subsidy rates are calculated in accordance with the methodology specified in the FCRA. This methodology takes into account expected costs (primarily claims) and gains (primarily premium revenue) associated with loans insured in a given year, and arrives at a net present value of the future cash flows on these loans by using interest rates on Treasury bonds as a discount rate. The interest rate on Treasury bonds does not account for market risk, because Treasury bonds are assumed to be virtually risk-free. However, some have suggested that credit subsidy rate estimates would more accurately reflect the value of the mortgages if the discount rate included adjustments for market risk. Accounting for market risk in calculating credit subsidy is referred to as the "fair value" approach.

In 2011, the Congressional Budget Office (CBO) released a report that discusses the difference between FCRA accounting and a fair value approach specifically as it relates to FHA. (See Congressional Budget Office, *Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair-Value Basis*, May 18, 2011, http://www.cbo.gov/publication/41445.) The CBO report finds that using a fair value approach would have changed the estimate of FY2012 credit subsidy for the MMI Fund programs from a negative number to a positive number. This means that, had the fair value approach been used, the loans that FHA expected to insure in that year would have been projected to lose money rather than earn money over the life of the loans, and FHA would have required an appropriation in order to insure loans in that year.

The debate over how to calculate subsidy rates for FHA's loan program is part of a larger debate over whether subsidy costs of government loan guarantees in general should reflect an adjustment for market risk. For more information on the issues involved, see CRS Report R44193, *Federal Credit Programs: Comparing Fair Value and the Federal Credit Reform Act (FCRA)*.

In the President's FY2019 budget request, the credit subsidy rate for the MMI Fund, excluding reverse mortgages, was estimated to be negative 3.20% for FY2019. At an expected insurance volume of $230 billion, the budget estimated that the MMI Fund forward portfolio would earn about $7.4 billion in negative credit subsidy in FY2019.[24]

CBO does its own credit subsidy estimates, and these estimates are the ones that are used during the appropriations process. For FY2019, CBO estimated that FHA's single-family programs (excluding reverse mortgages) would generate about $6.9 billion in negative credit subsidy.[25] CBO's lower credit subsidy estimate, as compared to the budget request, results from slightly

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[23] Some examples of reasons for the differences in the original credit subsidy rates across years could include differences in the mortgage insurance premiums that were being charged in that year, differences in the anticipated credit quality of loans being insured, or differences in the expected future trajectory of economic factors (such as interest rates or house prices) that can impact prepayments, defaults, and the amount that FHA can recover after a foreclosure.

[24] See Office of Management and Budget, "Loan Guarantees: Subsidy Rates, Commitments, and Average Loan Size," in the Supplemental Materials to the President's Budget at https://www.whitehouse.gov/omb/budget/Supplemental, and U.S. Department of Housing and Urban Development, *FY2019 Congressional Budget Justifications*, p. 26-2, https://www.hud.gov/sites/dfiles/CFO/documents/29%20-%20FY19CJ%20-%20HSNG%20-%20Mortgage%20and%20Loan%20Insurance%20Program%20%28FHA%20Fund%29.pdf.

[25] Congressional Budget Office, *Estimated Budgetary Effects of Major Federal Programs that Guarantee Mortgages – CBO's April 2018 Baseline*, https://www.cbo.gov/sites/default/files/recurringdata/51297-2018-04-mortgages.pdf.

lower estimates of both the credit subsidy rate and overall loan volume for the FHA forward portfolio in FY2019.

Annual Credit Subsidy Rate Re-estimates

The amount of money that loans insured by FHA in a given year actually earn for or cost the government over the course of their lifetime is likely to be different from the original credit subsidy estimates due to better or worse than expected performance of those loans. Federal credit reform accounting recognizes this, and provides permanent and indefinite budget authority to federal credit programs to cover any increased costs of loan guarantees in the future.

Each year, in consultation with OMB, FHA re-estimates each prior year's credit subsidy rates based on the actual performance of the loans and other factors, such as updated economic projections. Although the original credit subsidy rate for the single-family mortgage insurance program each year has historically been estimated to be negative, the credit subsidy rate re-estimates for the loans insured in several fiscal years are currently estimated to be positive, suggesting that FHA will actually pay out more money than it earns on the loans insured in those years.

Table 1 shows the original credit subsidy rate estimates and the most current re-estimated credit subsidy rates (as of the date of this report) for the loans insured in each fiscal year between 1992 and 2017. The first column shows the original credit subsidy rate. In all cases the original subsidy rate estimates were negative (shown in green), meaning that the loans insured in those years were originally expected to make money for the government. The second column shows the current re-estimated credit subsidy rate for each year. Re-estimated credit subsidy rates are shown in green if they remained negative (even if they are less favorable than the original estimate) and in red if they have become positive. (See the PDF version of this report to see the table in color.)

For most years, the current re-estimated credit subsidy rate is less favorable than the original estimate, although many of the re-estimated credit subsidy rates are still negative. A lower, but still negative, credit subsidy estimate suggests that the loans insured in that fiscal year will still make money for the government, but less than was originally estimated. In the years between FY2000 and FY2009, the re-estimates of the subsidy rates are positive (shown in red), meaning that the loans insured in these years are currently expected to lose money overall. In six years—FY1992, FY2010, FY2011, FY2012, FY2013, and FY2016—the current re-estimated subsidy rate is more favorable than the original estimated subsidy rate, meaning that the loans insured in those years are now expected to make more money than originally estimated.

Table 1. MMI Fund Credit Subsidy Rates and Re-estimates

(FY1992-FY2017)

Fiscal Year	Original Subsidy Rate	Re-estimated Subsidy Rate
1992	-2.60%	-3.22%
1993	-2.70%	-2.68%
1994	-2.79%	-1.82%
1995	-1.95%	-0.75%
1996	-2.77%	-1.06%
1997	-2.88%	-1.01%
1998	-2.99%	-1.44%

Fiscal Year	Original Subsidy Rate	Re-estimated Subsidy Rate
1999	-2.62%	-1.24%
2000	-1.99%	0.32%
2001	-2.15%	0.29%
2002	-2.07%	0.62%
2003	-2.53%	1.33%
2004	-2.47%	3.02%
2005	-1.80%	8.55%
2006	-1.70%	8.72%
2007	-0.37%	12.02%
2008	-0.25%	8.40%
2009	-0.05%	1.91%
2010	-0.86%	-0.90%
2011	-3.10%	-3.24%
2012	-2.53%	-5.18%
2013	-7.22%	-7.41%
2014	-7.25%	-4.91%
2015	-9.03%	-4.26%
2016	-3.70%	-3.78%
2017	-4.42%	-3.46%

Source: Table created by CRS based on Office of Management and Budget, *The President's Budget for Fiscal Year 2019, Federal Credit Supplement Spreadsheets, Loan Guarantees: Subsidy Re-estimates*, http://www.whitehouse.gov/omb/budget/Supplemental.

Note: These credit subsidy rates do not include FHA-insured reverse mortgages.

MMI Fund Account Balances

The credit subsidy rate re-estimates affect the way in which funds are held in the MMI Fund. The MMI Fund consists of two primary accounts: the Financing Account and the Capital Reserve Account.[26] The Financing Account holds funds to cover *expected* future losses on FHA-insured loans. The Capital Reserve Account holds additional funds to cover any additional, *unexpected* future losses. Funds are transferred between the two accounts each year on the basis of the re-estimated credit subsidy rates to ensure that enough is held in the Financing Account to cover updated projections of expected losses on insured loans. If the credit subsidy rate re-estimates reflect an aggregate *increase* in expected losses, funds are transferred from the Capital Reserve Account to the Financing Account to cover the amount of the increase in expected losses. If the credit subsidy rate re-estimates reflect a *decrease* in aggregate expected losses, funds are transferred from the Financing Account to the Capital Reserve Account.

[26] The Capital Reserve Account is an on-budget account; the Financing Account is an off-budget account that reflects the actual cash flows associated with loans insured under the MMI Fund.

Table 2 illustrates the changes in these account balances between FY2008 and FY2018. In the years following the housing market turmoil that began around 2007, the credit subsidy rate re-estimates showed aggregate increases in expected losses on FHA-insured loans, requiring large transfers of funds from the Capital Reserve Account to the Financing Account to cover these additional expected future losses. At the end of FY2008, the MMI Fund held $9 billion in the Financing Account and $19.3 billion in the Capital Reserve Account. The amounts needed in the Financing Account increased over the next several years and the amounts held in the Capital Reserve Account decreased, reaching zero at the end of FY2013 (when the MMI Fund received funds from Treasury to make a required transfer of funds to the Financing Account). By the end of FY2014, the MMI Fund had begun to rebuild its reserves, holding $7.3 billion in the Capital Reserve Account. As of the end of FY2018, the Capital Reserve Account held $27.2 billion.[27]

Table 2. MMI Fund Account Balances, FY2008-FY2018

($ in billions)

Fiscal Year	Financing Account	Capital Reserve Account	Total
FY2008	$9.0	$19.3	$28.2
FY2009	$21.1	$10.7	$31.8
FY2010	$28.9	$4.4	$33.3
FY2011	$29.0	$4.7	$33.7
FY2012	$35.1	$3.3	$38.4
FY2013	$48.4	$0.0	$48.4
FY2014	$38.9	$7.3	$46.2
FY2015	$29.6	$16.0	$45.6
FY2016	$12.6	$37.2	$49.8
FY2017	$18.5	$31.6	$50.1
FY2018	$23.0	$27.2	$50.2

Source: U.S. Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress*, for FY2008 through FY2018, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.

Notes: Figures reflect total account balances as of the fourth quarter of each fiscal year. Account balances represent the amount of liquid assets that are immediately available to pay for claim expenses, not the overall asset position of the MMI Fund.

Although the total resources held in these accounts have increased over the last several years, the total dollar volume of mortgages insured by FHA has also increased, from about $400 billion at the end of FY2008 to about $1.3 trillion at the end of FY2018.[28]

[27] U.S. Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress, FY2018 Q4,* p. 11, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.

[28] These figures represent total amortized insurance-in-force for the MMI Fund (that is, the current aggregate loan amount outstanding, rather than the initial aggregate loan amount). Figures come from 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 2009,* p. 17, and the *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2018,* p. 63.

Permanent and Indefinite Budget Authority

Recognizing the fact that estimating the lifetime cost of loan guarantees is inexact, the Federal Credit Reform Act of 1990 includes permanent and indefinite budget authority for federal loan guarantee programs to cover the cost of credit subsidy rate re-estimates.[29] Therefore, if FHA ever needs to transfer more money than it has in the Capital Reserve Account to the Financing Account to cover an increase in expected losses on insured loans, it can draw on its permanent and

[29] 2 U.S.C. §661c(f).

indefinite budget authority to receive funds from Treasury to make this transfer without additional congressional action.[30]

Any funds drawn from Treasury to make a required transfer of funds to the Financing Account are not spent immediately. Rather, they are held in the Financing Account, and used to pay claims to lenders only if the rest of the funds in the Financing Account are exhausted. If economic conditions and loan performance improve, or if loans insured in the future bring in enough money to both cover their own costs and pay for past loans that defaulted, it is possible that any money received from Treasury would never actually be spent. On the other hand, if future insured loans do not bring in enough funds to cover losses on past loans, or if economic conditions and loan performance do not improve, any funds received from Treasury could eventually be spent to pay actual claims.

When the President's budget request for FY2014 was released in April 2013, it included an estimate that the MMI Fund would need a mandatory appropriation of $943 million from Treasury during FY2013 in order to make a required transfer of funds from the Capital Reserve

[30] The credit subsidy rate re-estimates are included as part of the President's budget that is usually released in February of each year. Any required transfer of funds between the Financing Account and the Capital Reserve Account usually occurs in May or June, but can happen as late as September.

Account to the Financing Account.[31] FHA had until the end of FY2013 to make the required transfer of funds, and there was a possibility that the MMI Fund would bring in enough additional funds through the negative credit subsidy it earned on loans that it insured in FY2013 to make the required transfer without depleting the Capital Reserve Account. However, due to reduced loan volumes in FY2013, the MMI Fund earned less than anticipated during the year.

At the end of September 2013, HUD announced that the MMI Fund needed about $1.7 billion to ensure that enough money was available in the Financing Account to cover all expected future losses on insured loans. It received these funds from Treasury using the permanent and indefinite budget authority provided under the FCRA. This amount was nearly twice what was anticipated in the President's budget, and represented the first time that FHA had ever needed funds from Treasury to make a required transfer of funds from the Capital Reserve Account to the Financing Account.[32] FHA has not needed to draw additional funds from Treasury since that time.

Where to Find Key Information on the MMI Fund in Federal Budget Documents

- FHA's estimates of credit subsidy rates and the dollar amounts of loans that FHA expects to insure in the upcoming fiscal year are provided in the HUD budget justifications for the MMI Fund. HUD budget justifications are available on HUD's website at https://www.hud.gov/program_offices/cfo/budget.
- The re-estimated credit subsidy rates for the loans that FHA insured in previous years are in the Federal Credit Supplement of the President's budget. The Federal Credit Supplement is available at https://www.whitehouse.gov/omb/supplemental-materials/.
- If FHA expects to need funds from Treasury during a fiscal year to cover higher-than-expected future costs of loan guarantees, the amount that FHA expects to need is reflected as a mandatory appropriation in the Appendix of the President's budget.[33] The most current Budget Appendix is at https://www.whitehouse.gov/omb/appendix/. Prior years' Budget Appendices can be accessed at https://www.gpo.gov/fdsys/browse/collectionGPO.action?collectionCode=BUDGET.

[31] *The Appendix, Budget of the United States Government, Fiscal Year 2014*, p. 574, https://www.gpo.gov/fdsys/pkg/BUDGET-2014-APP/pdf/BUDGET-2014-APP.pdf.

[32] The President's FY2013 budget request had indicated that FHA could need to draw on its permanent and indefinite budget authority for $688 million during FY2012. (See *The Appendix, Budget of the United States Government, Fiscal Year 2013*, p. 636, https://www.gpo.gov/fdsys/pkg/BUDGET-2013-APP/pdf/BUDGET-2013-APP-1-13.pdf.) However, FHA did not end up needing funds from Treasury that year. Increases in mortgage insurance premiums for new borrowers, as well as money that FHA received in settlements with large mortgage companies related to claims that the companies did not adhere to FHA requirements in originating and servicing loans, brought in enough funds to make the required transfer. See the Written Testimony of Shaun Donovan, Secretary of U.S. Department of Housing and Urban Development, Hearing before the Subcommittee on Transportation, Housing and Urban Development, and Related Agencies, U.S. House of Representatives Committee on Appropriations on "FY2013 Budget Request for the Department of Housing and Urban Development," March 21, 2012, p. 7, http://appropriations.house.gov/uploadedfiles/hhrg-112-ap20-wstate-sdonovan-20120321.pdf; and U.S. Congress, Senate Committee on Appropriations, Subcommittee on Transportation, Housing and Urban Development, and Related Agencies, *Hearing on President Obama's Fiscal 2014 Budget Proposal for the Federal Housing Administration*, 113th Cong., 2nd sess., June 4, 2013.

[33] For example, in the FY2014 budget request, p. 574 of the Appendix reflects that FHA expected to need $943 million from Treasury for the MMI Fund in FY2013. (The actual amount that FHA ultimately needed from Treasury was higher, at $1.7 billion.)

Annual Actuarial Review and Annual Report to Congress on the Financial Status of the MMI Fund

Separately from the annual budget process, FHA is required by law to obtain an independent actuarial review each year that analyzes the financial position of the MMI Fund and to provide an annual report to Congress on the results of the actuarial review.[34] This review traditionally analyzes the MMI Fund's financial position by reporting the amount of funds that it currently has on hand and estimating the net amount (in present value terms) that it expects to earn or lose in the future on loans that it currently insures. These numbers are added together to compute the "economic value" of the MMI Fund. The economic value is the amount of money that the MMI Fund would be projected to have on hand after all of the cash flows associated with its insured loans are realized, assuming that it does not insure any more loans going forward. The results of the actuarial review are presented in FHA's annual report to Congress on the financial status of the MMI Fund.

The budgetary treatment and the actuarial review of the MMI Fund are two different ways of looking at the same thing—namely, how the loans insured under the MMI Fund have performed and are expected to perform in the future, and the effect of this loan performance on the financial position of the MMI Fund. However, the annual actuarial review is separate from the federal budget process, and uses somewhat different economic assumptions than those used in the federal budget. This section describes the actuarial review and accompanying annual report to Congress along with important related concepts. It then discusses the results of the FY2018 actuarial review and annual report that were released in November 2018.

In the annual actuarial review, the independent actuary reviews the MMI Fund's financial information to estimate the MMI Fund's current financial position, including both forward and reverse mortgages insured under the fund.[35] This usually includes reporting the amount of funds that the MMI Fund currently has on hand and estimating the cash flows that it expects in the future—such as premiums paid into the fund and claims paid out of the fund—on the loans that it currently insures. It uses economic modeling to project the MMI Fund's financial status for the current year and several years into the future under a "base case" scenario and several alternative economic scenarios. Some of the key terms used in the actuarial report and FHA's annual report on the financial status of the MMI Fund include the following:

- ***Capital resources*** are the net assets (assets[36] minus liabilities) that the MMI Fund *currently* has on hand that can be converted into cash to pay claims on defaulted mortgages or other expenses.

[34] This requirement was originally codified at 12 U.S.C. 1711(g) and was enacted as part of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) and the Cranston-Gonzalez National Affordable Housing Act of 1990 (P.L. 101-625). (Both laws included identical provisions related to the actuarial soundness of the MMI Fund; P.L. 101-508 was enacted first.) Since the enactment of the Housing and Economic Recovery Act of 2008 (P.L. 110-289), the requirement for an annual independent actuarial review is codified at 12 U.S.C. 1708(a)(4).

[35] There are actually two annual actuarial reviews: one analyzes only traditional FHA-insured single-family forward mortgages, and the other analyzes only FHA-insured reverse mortgages. Both of these actuarial reviews can be found at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/actr/actrmenu. FHA combines the numbers from the two actuarial reviews to arrive at a total economic value of the MMI Fund in the *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund*, which can be found at http://portal.hud.gov/hudportal/HUD?src=/fhammifrpt.

[36] The MMI Fund's assets include things such as cash, Treasury investments, and foreclosed properties held by HUD.

- ***Present value of future cash flows on outstanding business*** is the estimated amount that the MMI Fund is currently expected to gain or lose in the future, in present value terms, on the loans that it currently insures (this estimate does not take into account any new loans that might be insured in the future).
- ***Economic value*** or ***economic net worth*** is the MMI Fund's capital resources plus the present value of its future cash flows on outstanding business. It represents the amount of capital resources that the MMI Fund would have after expected future cash flows on currently insured loans are realized. In other words, it represents the amount that the MMI Fund could use to pay for any additional, unexpected losses on its outstanding loans.

The law also mandates that FHA meet a 2% capital ratio requirement, which means that the economic value of the MMI Fund must be at least 2% of the total dollar volume of mortgages that FHA currently insures.[37] The capital ratio is calculated on the basis of the actuarial report. The capital ratio fell below this 2% requirement in FY2009 and remained below 2% for several years thereafter, turning negative in FY2012 and FY2013. The capital ratio was estimated to be positive again in FY2014 and was estimated to exceed 2% in FY2015 and each subsequent year to date.

FY2018 Results

The FY2018 annual actuarial review and FHA's accompanying annual report to Congress on the MMI Fund's financial status were released in November 2018. In its annual report, FHA reported the MMI Fund's total capital resources to be $49.2 billion. This is the amount of resources that FHA currently has on hand that can be converted into cash to pay claims. FHA estimated the present value of future cash flows on insured loans (including both forward and reverse mortgages) to be *negative* $14.4 billion. In other words, in net present value terms, the loans that FHA currently insures are expected to cost FHA about $14.4 billion over the remaining life of those loans. The economic value of the MMI Fund, therefore, was estimated by FHA to be approximately $34.9 billion ($49.2 billion-$14.4 billion), including both forward and reverse mortgages.[38] The independent actuary separately estimated the present value of future cash flows on insured loans for the MMI Fund. While the actuary's estimate differed somewhat from FHA's, it found FHA's estimate to be reasonable.[39]

Where to Find FHA Reports on the MMI Fund

The FHA reports discussed in this section, including the annual actuarial review and FHA's annual report to Congress on the financial status of the MMI Fund, can be accessed from HUD's Office of Housing Reading Room web page at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgrroom.

[37] 12 U.S.C. 1711(f)

[38] 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 2018*, November 15, 2018, p. 63, https://www.hud.gov/sites/dfiles/Housing/documents/2018fhaannualreportMMIFund.pdf.

[39] The independent actuary calculated the net present value of future cash flows on insured forward loans to be positive $3.5 billion, compared to FHA's estimate of positive $1.4 billion. It calculated the net present value of future cash flows on insured HECMs to be negative $14.2 billion, compared to FHA's estimate of negative $15.7 billion. Combined, FHA's estimate of the present value of future cash flows for the MMI Fund is negative $14.4 billion while the actuary's is negative $10.7 billion. See Pinnacle Actuarial Resources, Inc., *Fiscal Year 2018 Independent Actuarial Review of the Mutual Mortgage Insurance Fund: Cash Flow Net Present Value from Forward Mortgage Insurance-in-Force*, November 15, 2018, pp. 1-2; Pinnacle Actuarial Resources, Inc., *Fiscal Year 2018 Independent Actuarial*

The estimated economic value of $34.9 billion was an increase of about $8.1 billion compared to FY2017, when the MMI Fund was estimated to have an economic value of $26.7 billion.[40]

In FY2012 and FY2013, the MMI Fund was estimated to have a *negative* economic value. A negative economic value means that the funds that the MMI Fund currently has on hand, plus the present value of the funds that it expects to earn in premiums on loans that it currently insures, would not be enough to pay for the present value of claims on the loans that are currently insured. For example, in FY2013 the MMI Fund was estimated to have an economic value of negative $1.3 billion. This meant that, based on the MMI Fund's capital resources and estimates of future cash flows on insured loans as of the time the report was prepared, FHA was expected to be short about $1.3 billion when all of its currently insured loans were eventually paid off.[41] In contrast, the FY2018 economic value of positive $34.9 billion means that the MMI Fund would be estimated to have that amount left over after all of the expected future cash flows (including premium payments and insurance claims) on its currently insured mortgages were realized. This provides a "cushion" should future losses on insured mortgages be higher than currently anticipated.

The projections included in the actuarial report and the annual report to Congress rely on several assumptions. For one thing, the estimates of the MMI Fund's current status assume that FHA will not insure any more mortgages. In actuality, FHA will likely continue to insure loans, which will bring in additional resources in the form of premium revenues, but will also create new liabilities in terms of claims.

Furthermore, the actuarial review relies upon assumptions about future economic conditions. To the extent that actual future economic conditions differ from these assumptions, the estimates of the MMI Fund's value will also be different.[42] Although FHA estimates that the MMI Fund's economic value in FY2018 is positive $34.9 billion, it notes that, under a variety of alternative future economic scenarios, the MMI Fund's economic value could be different, including potentially negative values in certain severe economic scenarios. Both the actuarial report and the

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Review of the Mutual Mortgage Insurance Fund: Cash Flow Net Present Value from Home Equity Conversion Mortgage Insurance-in-Force, November 15, 2018, pp. 1-2; and 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 2018*, p. 64.

[40] The FY2017 economic value of the MMI Fund shown in the text is the restated value as reported in the *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2018* to correct a material error, and therefore it differs from the economic value that was reported in the FY2017 annual report to Congress. The revised value of $26.7 billion is $1.1 billion higher than the economic value of $25.6 billion that was reported in the FY2017 annual report to Congress. See p. 64 of the FY2018 annual report to Congress for more information on the revision.

[41] A negative economic value does not mean that FHA is currently out of money. Projected losses on the loans insured by FHA are realized over the life of those loans, rather than all at once, potentially giving FHA time to increase its capital resources before these projected losses are realized. Whether or not the MMI Fund will ever actually run out of money to pay claims depends on factors such as whether the projections of future cash flows are accurate and whether the MMI Fund is able to build enough additional capital resources over time, such as through additional premium revenue from newly insured mortgages, to pay for these expected claims.

[42] To understand how assumptions about future economic conditions affect estimates of the MMI Fund's current value, consider that, for example, the *future* path of house prices affects *current* estimates of future cash flows on mortgages insured under the MMI Fund. If house prices fall more than expected in the future, then cash flows on currently insured mortgages might be more negative than currently anticipated due to more foreclosures and foreclosed properties held by FHA selling for less money; if house prices rise more than expected in the future, then cash flows on currently insured mortgages might be more positive than currently anticipated due to fewer foreclosures and foreclosed properties selling for more money. Likewise, assumptions about other economic indicators in the future also impact current estimates of future cash flows associated with currently insured mortgages.

annual report to Congress include an analysis of the MMI Fund's financial position under various alternative economic scenarios.[43]

The 2% Capital Ratio Requirement

As noted earlier, the MMI Fund is also required by law to maintain a capital ratio of 2%.[44] This is often referred to as the capital ratio requirement.

Brief History of the Capital Ratio Requirement

The capital ratio requirement for the MMI Fund was enacted in 1990 amid concerns about the solvency of the FHA single-family mortgage insurance program. At the time, the MMI Fund had a negative economic value. This meant that the expected future cash flows associated with the mortgages currently insured by the MMI Fund, when combined with the capital resources that the MMI Fund currently had on hand, were not expected to be enough to pay for all future claims on FHA-insured loans.

In response to these concerns, the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) mandated that, going forward, the MMI Fund's economic value must be at least 2% of the total dollar amount of loans that it is currently insuring.[45] The capital ratio is an expression of the economic value of the MMI Fund as a percentage of the total dollar volume of loans insured by the MMI Fund. It is a measure of how much capital the MMI Fund will have available to pay for *unexpected* losses on currently insured loans, after the amounts estimated to be needed to cover *expected* losses are taken into account.

In addition to establishing the capital ratio requirement, P.L. 101-508 also directed FHA to make certain changes that were intended to improve the MMI Fund's financial condition. The changes that the law required included charging borrowers an annual mortgage insurance premium to go along with the existing premium that was paid upfront and suspending certain payments (known as distributive shares) that had previously been paid to borrowers under certain conditions. The law also established the requirement for the annual independent actuarial review of the MMI Fund. Some of these changes, such as the additional mortgage insurance premium, essentially meant that FHA would charge more to future borrowers to build up reserves to pay for losses on mortgages made to past borrowers.

As Congress considered the legislation prior to enactment, there was debate over the appropriate level for the capital ratio requirement.[46] This debate highlights the ongoing tension that FHA faces between maintaining its financial soundness and carrying out its purpose of expanding

[43] See the discussion on pp. 80-86 of the *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2018,* pp. 33-39 of the *Fiscal Year 2018 Independent Actuarial Review of the Mutual Mortgage Insurance Fund: Cash Flow Net Present Value from Forward Mortgage Insurance-in-Force*, and pp. 25-30 of the *Fiscal Year 2018 Independent Actuarial Review of the Mutual Mortgage Insurance Fund: Cash Flow Net Present Value from Home Equity Conversion Mortgage Insurance-in-Force*.

[44] 12 U.S.C. 1711(f)

[45] The law calls for the capital ratio to be calculated as the economic value of the MMI Fund divided by unamortized insurance-in-force. Unamortized insurance-in-force is generally understood to mean the original principal balance of insured mortgages. However, the law defines unamortized insurance-in-force as "the remaining obligation on outstanding mortgages," a definition that is usually understood to be amortized insurance-in-force. Historically, the actuarial reports often included both amortized and unamortized insurance-in-force as generally understood, allowing the capital ratio to be calculated both ways.

[46] See the discussion of the history of the capital ratio in Charles A. Capone Jr., "Credit Risk, Capital, and Federal Housing Administration Mortgage Insurance," Journal of Housing Research, Volume 11, Issue 2, pp. 373-401.

access to affordable mortgage credit for underserved borrowers. The 2% threshold was adopted because it was viewed as being high enough to provide FHA with a cushion to withstand some unexpected losses, but without imposing an undue financial burden on future FHA-insured borrowers. A higher capital ratio requirement would have likely required FHA to charge higher premiums for FHA insurance. It was recognized that a 2% requirement would likely be high enough to withstand moderate future economic downturns, but would likely not be high enough to allow the MMI Fund to withstand a catastrophic economic downturn. According to testimony from the General Accounting Office (GAO, now the Government Accountability Office) from 2000:

> Determining what constitutes an adequate reserve level is essentially a question of what kinds of adverse economic conditions—moderately severe or catastrophic—the reserve should be able to withstand.... In the actuarial review of the Fund conducted by Price Waterhouse for fiscal year 1989, the researchers concluded that actuarial soundness would be consistent with a reserve that could withstand adverse, but not catastrophic, economic downturns. They further concluded that the Treasury implicitly covers catastrophic risk.... By contrast, rating agencies have taken the position, when evaluating private mortgage insurers, that they should have enough capital to withstand catastrophic risk.... However, requiring FHA to hold capital equivalent to that held by private mortgage insurers would likely impair FHA's public purpose.[47]

While the law requires the Secretary of HUD to ensure that the MMI Fund maintains a capital ratio of 2%, it does not currently specify consequences or specific actions that the Secretary must take if the capital ratio falls below that threshold.[48] Furthermore, GAO has noted that the 2% capital ratio requirement does not take into account specific economic conditions the MMI Fund should be expected to withstand. It has suggested that Congress could consider enacting legislation to specify such conditions, and to require FHA to maintain a capital ratio that is based on the MMI Fund's ability to withstand those specific economic scenarios.[49]

While the results of the actuarial review and the estimate of the capital ratio provide important information about the financial soundness of the MMI Fund, the results of the actuarial review and the capital ratio estimate do not determine whether or not FHA will need to draw on its permanent and indefinite budget authority with Treasury for funds to hold against expected future losses or to pay claims. That is determined as part of the re-estimate process that is done as part of the federal budgeting process each year, which is described in the "The MMI Fund in the Federal Budget" section of this report.

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[47] U.S. General Accounting Office, *Mortgage Financing: Financial Health of the Federal Housing Administration's Mutual Mortgage Insurance Fund*, Statement of Stanley J. Czerwinski before the Subcommittee on Housing and Transportation, Senate Committee on Banking, Housing and Urban Affairs, September 12, 2000, pp. 7-8, http://gao.gov/assets/110/108623.pdf.

[48] The capital ratio requirement is codified at 12 U.S.C. §1711(f). A separate section of the law, 12 U.S.C. §1708(a)(3), also requires the Secretary to make sure that the MMI Fund is financially sound. 12 U.S.C. 1708(a)(6) provides that the Secretary "may" make adjustments to the FHA program or adjust mortgage insurance premiums if the MMI Fund is not meeting certain goals or if there is "substantial probability" that the MMI Fund will not meet the 2% capital ratio. However, there are no specific actions that the Secretary is directed to take if the 2% capital ratio requirement is not met.

[49] See, for example, Government Accountability Office, *Federal Housing Administration: Capital Requirements and Stress Testing Practices Need Strengthening*, GAO-18-92, November 2017, https://www.gao.gov/products/GAO-18-92.

FY2018 Capital Ratio

The capital ratio is reported in FHA's annual report to Congress on the financial status of the MMI Fund, using the actuarial report's numbers for both traditional single-family forward mortgages and reverse mortgages insured by FHA. In FY2018, the annual report estimated the economic value of the MMI Fund to be $34.9 billion. The total dollar volume of mortgages currently insured by the MMI Fund was $1.265 trillion, which means that the capital ratio was estimated to be 2.76% ($34.9 billion divided by $1.265 trillion). This represents an increase from FY2017, when the capital ratio was estimated to be 2.18%.[50] The capital ratio remained above 2% for the fourth straight year; FY2015 was the first time the capital ratio had exceeded 2% since FY2008.

In FY2009, the capital ratio was estimated to be 0.53%.[51] This was the first time that the capital ratio had fallen below 2% since the requirement was first met in FY1995.[52] The capital ratio remained below 2% from FY2009 through FY2014, when the capital ratio was estimated to be 0.41%.[53] In FY2012 and FY2013, the capital ratio was estimated to be *negative* 1.44% and *negative* 0.11%, respectively.[54] FY2012 was the first time that the MMI Fund had been estimated to have a negative capital ratio since the early 1990s, when Congress enacted the series of changes aimed at ensuring the financial soundness of the MMI Fund, including the requirement for an independent annual actuarial review and the required capital ratio.[55]

A negative capital ratio by itself does not trigger any special assistance from Treasury, although it suggests that such assistance could be needed at some point. Rather, any assistance from Treasury is triggered if the credit subsidy rate re-estimates described in the "Annual Credit Subsidy Rate Re-estimates" section show that FHA needs to transfer more funds than it has in its Capital Reserve Account into its Financing Account to cover increases in expected future losses. The amount of assistance required from Treasury is based on the credit subsidy rate re-estimates, not on the capital ratio or the economic value of the MMI Fund as reported in the actuarial report.

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[50] As described in footnote 40, the FY2017 numbers provided in the text are restated numbers as reported in the FY2018 annual report to Congress. The FY2017 annual report to Congress had estimated the capital ratio to be 2.09%, while the restated value is 2.18%. See p. 64 of the FY2018 annual report to Congress for more information on the revision.

[51] 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 2009*, November 12, 2009, p. 17, http://portal.hud.gov/hudportal/documents/huddoc?id=fhammifannrptfy2009.pdf.

[52] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "The FHA Single-Family Insurance Program: Performing a Needed Role in the Housing Finance Market," Executive Summary, p. 3, http://www.huduser.org/publications/pdf/FHA_SingleFamilyIns_2012.pdf. The discussion of the history of FHA notes that the capital ratio requirement of 2% was first reached in FY1995.

[53] 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, p. 35, https://www.hud.gov/sites/documents/FY2014FHAANNREP11_17_14.PDF.

[54] 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 2013*, December 13, 2013, p. 34, https://www.hud.gov/sites/documents/FY2013REPCONGFINSTMMIFUND.PDF.

[55] See, for example, General Accounting Office, *Mortgage Financing: Actuarial Soundness of the Federal Housing Administration's Mutual Mortgage Insurance Fund*, statement of Thomas J. McCool before the Subcommittee on Housing and Community Opportunity, House Committee on Financial Services, March 20, 2001, p. 2, showing an estimated negative economic value of the MMI Fund in 1990 and 1991.

Table 3 shows the MMI Fund's financial position, including its economic value, dollar volume of insured mortgages, and capital ratio, as estimated by the independent actuary and FHA for each fiscal year between FY2006 and FY2018.[56]

Table 3. Results of the Annual Actuarial Review of the MMI Fund, FY2006-FY2018
($ in millions)

Fiscal Year	Capital Resources	PV of Future Cash Flows	Economic Value	Dollar Volume of Insured Mortgages	Capital Ratio
FY2006	$23,461	-$1,440	$22,021	$298,542	7.38%
FY2007	$25,365	-$3,952	$21,277	$305,449	6.97%
FY2008	$27,281	-$14,374	$12,908	$401,461	3.22%
FY2009	$30,719	-$27,078	$3,641	$684,708	0.53%
FY2010	$33,594	-$28,937	$4,657	$931,272	0.50%
FY2011	$32,431	-$29,880	$2,551	$1,078,000	0.24%
FY2012[a]	$30,362	-$46,638	-$16,277	$1,131,543	-1.44%
FY2013[a]	$29,680	-$31,010	-$1,330	$1,178,154	-0.11%
FY2014[a]	$28,432	-$23,667	$4,765	$1,156,741	0.41%
FY2015[a]	$30,862	-$7,040	$23,822	$1,151,458	2.07%
FY2016[a]	$35,346	-$7,795	$27,551	$1,188,569	2.32%
FY2017[b]	$40,857	-$14,112	$26,745	$1,226,843	2.18%
FY2018	$49,237	-$14,375	$34,862	$1,264,672	2.76%

Source: U.S. Department of Housing and Urban Development, *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund*, for FY2006 through FY2018.

Notes: Figures are based on the base case scenario reported in the actuarial reports. The dollar volume of insured mortgages is amortized insurance-in-force. FHA-insured reverse mortgages became part of the MMI Fund in FY2009.

a. In FY2017, FHA aligned the values used for capital resources and dollar volume of insured mortgages with reporting in FHA's annual audited financial statements. These changes were also applied to recent previous years, resulting in slight changes to the capital ratios for FY2012-FY2016 (between 0.01 and 0.10 percentage points). The table reflects the values reported in the applicable year's annual reports for the years prior to FY2017 rather than the revised figures.

b. FHA restated its FY2017 figures for capital resources, economic value, and the capital ratio in the FY2018 annual report due to a correction of a material error in the reporting of FHA's assets for FY2017. The restated figures are slightly higher than those that were originally reported. The FY2017 figures provided in the table are the restated figures provided in the FY2018 annual report.

The drop in the capital ratio in the years after 2008 resulted from both a decrease in the numerator of the ratio (the MMI Fund's economic value) and an increase in the denominator of the ratio

56 The FY2017 annual report to Congress on the MMI Fund's financial status presented slightly revised capital ratios for FY2012 through FY2016 as a result of an effort to align the figures used for certain components of the capital ratio with other FHA financial reporting. The figures in the text and in the table are the ones that were reported in the original actuarial reviews and annual reports for those fiscal years rather than the revised figures; the difference between the original estimates and the revised figures ranges from 0.01 to 0.10 percentage points. Specifically, the revised capital ratios reported in the *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2017* were -1.34% for FY2012, -0.12% for FY2013, 0.42% for FY2014, 2.10% for FY2015, and 2.35% for FY2016. See p. 59 of the report.

(total dollar volume of mortgages outstanding), which reflects the fact that FHA is insuring a greater volume of loans than it has in the recent past. The decrease in the MMI Fund's economic value, in turn, was mostly due to the fact that the present value of future cash flows became increasingly negative for a time, suggesting that FHA was expecting large net cash outflows over the life of the loans that it was currently insuring.

Selected Current Issues Related to the Financial Status of the MMI Fund

This section briefly describes selected current issues related to the financial status of the MMI Fund, and in particular certain issues that are often discussed in the context of the annual actuarial review and annual report to Congress. Namely, it discusses the inclusion of reverse mortgages in the MMI Fund, debate over the appropriate level for the premiums charged for FHA-insured mortgages, and certain trends in FHA-insured mortgage characteristics that FHA identified in its FY2018 annual report as worthy of monitoring.

Role of FHA-Insured Reverse Mortgages in the Annual Actuarial Review

FHA-insured reverse mortgages, known as Home Equity Conversion Mortgages (HECMs), were moved into the MMI Fund beginning in FY2009. In contrast to traditional forward mortgages, HECMs are FHA-insured reverse mortgages for elderly homeowners who are seeking to access their accumulated home equity.[57] HECMs that were insured by FHA prior to FY2009 are obligations of a different FHA insurance fund, but HECMs insured in FY2009 or later are obligations of the MMI Fund.[58]

The dollar amount of HECMs insured under the MMI Fund is much smaller than the amount of traditional forward mortgages: about $72 billion of the $1.3 trillion of insurance-in-force under the MMI Fund are HECMs.[59] However, changes in the estimated value of HECMs can have a significant impact on the MMI Fund's overall economic value and on the capital ratio.

Estimates of HECM performance are particularly sensitive to economic assumptions, such as future house prices and interest rates, making the value of the HECM portfolio volatile. While the value of forward mortgages insured under the MMI Fund has consistently increased since FY2012, the value of HECMs has fluctuated between negative and positive values and has become increasingly negative in recent years.[60]

[57] For more information on HECMs, see CRS Report R44128, *HUD's Reverse Mortgage Insurance Program: Home Equity Conversion Mortgages*.

[58] HECMs endorsed prior to FY2009 are obligations of the General and Special Risk Insurance Fund (GI/SRI Fund). The Housing and Economic Recovery Act of 2008 (HERA, P.L. 110-289) made HECMs an obligation of the MMI Fund going forward.

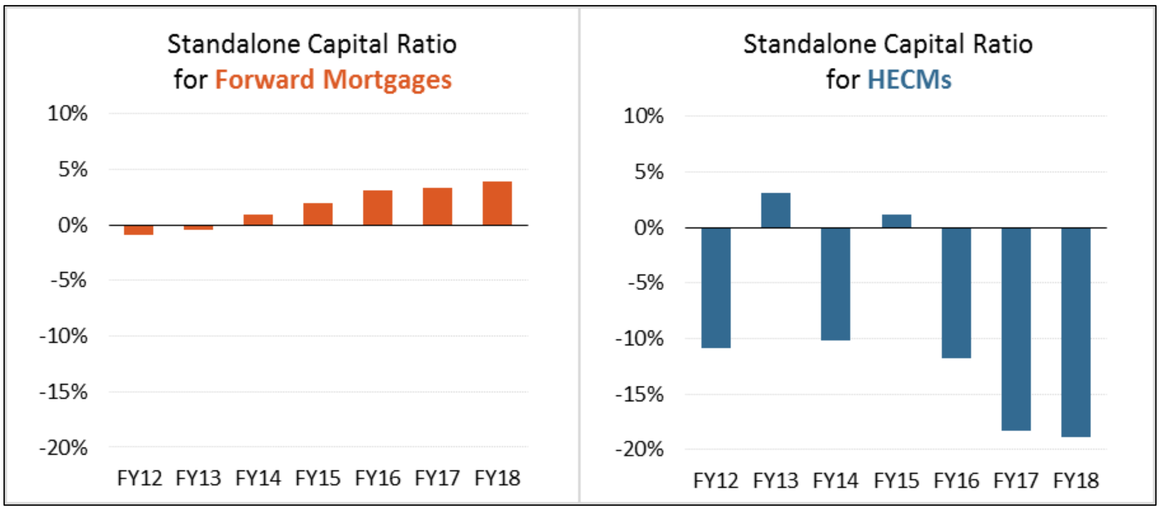
[59] U.S. Department of Housing and Urban Development, *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2018*, p. 72. HECM insurance-in-force is the aggregate unpaid principal balance of HECMs insured under the MMI Fund. The FHA annual reports began reporting HECM insurance-in-force this way in FY2017, rather than using the maximum claim amount for these mortgages, as was used in prior years. See pp. 7-8 of the FY2017 annual report and p. 17 of the FY2018 annual report for more information on this change.

[60] U.S. Department of Housing and Urban Development, *Annual Report to Congress Regarding the Financial Status of*

The volatility in the HECM portfolio can be seen in the results of recent actuarial reviews and in the standalone capital ratios for the forward and HECM portfolios as reported by FHA. As shown in **Figure 1**, the standalone capital ratio for the forward mortgage portfolio alone has steadily increased from negative 0.91% in FY2012 to positive 3.93% in FY2018. In comparison, the standalone capital ratio for HECMs has fluctuated during that time period, ranging from a high of positive 3.07% in FY2013 to a low of negative 18.83% in FY2018.[61] (The capital ratio for the overall MMI Fund in FY2018 was estimated to be 2.76%.) Given the smaller overall insurance volume of the HECM portfolio, changes in the portfolio's economic value can have a larger impact on the HECM standalone capital ratio than a comparable dollar volume change in the larger forward portfolio would have on its standalone capital ratio. Nevertheless, the trends in the standalone capital ratios illustrate differences in the performance of the two portfolios.

Figure 1. Standalone Capital Ratios for Forward Mortgages and HECMs

FY2012-FY2018



Source: HUD's *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund*, FY2017 (pp. 62 and 64) and FY2018 (pp. 68 and 72).

Notes: Standalone capital ratios are those reported in the FY2017 and FY2018 annual reports, which reflect methodological changes for both current and prior-year figures.

The volatility of HECMs and their inclusion in the MMI Fund potentially raise some policy questions. In its FY2015 annual report on the status of the MMI Fund, FHA noted that including both HECMs and forward mortgages in the fund could make it more difficult to independently assess the financial health of the separate programs, particularly since the capital ratio for the entire MMI Fund is often used as a proxy for the performance of the much larger forward mortgage portfolio.[62] Furthermore, including both types of mortgages in the same fund could impact policies related specifically to forward mortgages, such as the level of fees paid by

the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016, p. 21, and *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2018*, pp. 68 and 72.

[61] These figures reflect certain methodological changes that FHA made in how it calculates the economic value and capital ratio for HECMs beginning in FY2017, including reflecting cross-subsidies between the two portfolios. Figures provided for past years use the updated methodology, whereas elsewhere in this report the figures used for the MMI Fund as a whole are those reported using the methodology that was in place at the time.

[62] 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 2015*, p. 44.

borrowers, in response to instability in the MMI Fund driven by HECMs.[63] For these reasons, some industry groups and other observers have argued that Congress should consider legislation to remove HECMs from the MMI Fund.[64] However, GAO and others have noted that removing HECMs from the MMI Fund would involve tradeoffs.[65]

Debate over FHA Premium Levels

The upfront and annual mortgage insurance premiums charged by FHA account for most of the revenue coming into the MMI Fund. As described earlier in the "Mortgage Insurance Premiums" section of this report, the levels of the premiums charged can impact the MMI Fund's status in several potentially conflicting ways. All else being equal, higher premiums should bring more money into the MMI Fund. However, higher premiums have the potential to negatively impact FHA's finances by leading to a reduction in FHA loan volume or impacting the credit quality of the loans that FHA insures. Higher premiums also increase the costs of FHA-insured mortgages for homebuyers, potentially making FHA-insured mortgages less affordable or pricing some potential homebuyers out of the market. Therefore, setting the appropriate levels for the mortgage insurance premiums requires striking a balance between maintaining affordability of FHA-insured mortgages and managing risk to the insurance fund.

In the years following the housing market turmoil that began around 2007, FHA increased the premiums that it charges for new FHA-insured forward mortgages several times. Most of these changes affected the annual premiums.[66] Following several increases, FHA decreased the annual mortgage insurance premiums that it charges in January 2015. The current annual premiums are at their lowest levels since the beginning of October 2010, though they are higher than the premiums that FHA was charging previously.

In recent years, as the capital ratio has increased over 2%, some industry groups and housing advocates have called for FHA to further reduce the mortgage insurance premiums it charges for forward mortgages (or to reduce the amount of time that it charges the premiums[67]), arguing that

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[63] 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 2015,* p. 42.

[64] For example, see the Mortgage Bankers Association, "FHA Insurance Fund Capital Reserves Fall; Capital Ratio Remains Above Threshold," press release, November 16, 2017, https://www.mba.org/mba-newslinks/2017/november/mba-newslink-thursday-11-16-17/fha-insurance-fund-capital-reserves-fall-capital-ratio-remains-above-threshold, and Edward Golding and Laurie Goodman, "To better assess the risk of FHA programs, separate reverse and forward mortgages," Urban Institute, Urban Wire blog post, November 29, 2017, https://www.urban.org/urban-wire/better-assess-risk-fha-programs-separate-reverse-and-forward-mortgages.

[65] GAO has described both advantages and disadvantages to including both forward and reverse mortgages in the MMI Fund; see GAO, *Federal Housing Administration: Capital Requirements and Stress Testing Practices Need Strengthening,* beginning on p. 25.

[66] FHA increased the upfront premium in 2010, but later reduced it after receiving statutory authority to raise the annual premium (FHA had previously been charging the highest annual premium that was allowed by statute at the time). Since April 2012, FHA has been charging the same upfront premium that it was charging from October 2008 until early April 2010. Between April 2010 and April 2012, the upfront premium was above the current level for a time, followed by a period where it was below the current level.

[67] Since June 2013, FHA has required most borrowers to pay the annual mortgage insurance premiums for the life of the loan. From 2001 until June 2013, FHA had allowed the annual premiums to be cancelled when the mortgage balance reached 78% of the home's initial value. Some have advocated for FHA to return to its previous policy. For more information on FHA's rationale for charging the premiums for the life of the loan, see 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 2012*, November 16, 2012, p. 54, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

the MMI Fund is strong enough to take such steps to increase the affordability of FHA-insured mortgages. The improvement in the MMI Fund's capital ratio in FY2018 again led to calls from some advocates and industry groups to decrease the mortgage insurance premiums.[68] However, FHA has reportedly indicated that it is not likely to reduce the premiums in the near future.[69]

Suspension of a Planned FHA Premium Decrease in 2017

On January 9, 2017, in the last weeks of the Obama Administration, FHA had announced that it would again decrease the annual mortgage insurance premiums charged to borrowers who took out new FHA-insured mortgages that closed on or after January 27, 2017.[70] However, on the first day of the Trump Administration, before the new premiums had gone into effect, FHA announced that it was suspending the planned premium reduction. In its announcement, FHA indicated a need to further study the impact that the fee decrease could have on the insurance fund and the long-term financial viability of FHA.[71]

In its FY2017 annual report to Congress on the financial status of the MMI Fund, FHA estimated that had the premium decrease gone into effect, the capital ratio for the MMI Fund would have been 1.76% in FY2017, below the statutorily mandated level of 2%. The lower capital ratio would have resulted from the combination of an estimated decrease of $3.2 billion in the net present value of expected future cash flows on insured mortgages (stemming from lower premiums that would have been paid on FHA-insured mortgages originated in FY2017, including some borrowers refinancing their existing FHA-insured mortgages into new mortgages with lower premiums) and an estimated increase of $45 billion in FHA's insurance-in-force (stemming from more people obtaining FHA-insured mortgages as a result of the premium decrease).[72]

These estimated differences in the net present value of future cash flows and insurance-in-force also would have reduced the economic net worth and the capital ratio for the forward mortgage portfolio alone. However, based on the figures provided in the annual report, the estimated capital ratio for forward mortgages alone would still have remained above 2% if the premium decrease had gone into effect, even though the capital ratio for the MMI Fund as a whole (including both forward mortgages and HECMs) would have fallen below that threshold.[73] The capital ratio for

[68] For example, see National Association of Home Builders, "Statement from NAHB Chairman Randy Noel on FHA Actuarial Report," November 15, 2018, http://nahbnow.com/2018/11/statement-from-nahb-chairman-randy-noel-on-fha-actuarial-report/.

[69] For example, see National Association of Home Builders, "FHA Capital Reserves Post Healthy Gain, but HUD Signals No Sign of a Premium Cut," press release, November 15, 2018, http://nahbnow.com/2018/11/fha-capital-reserves-post-healthy-gain-but-hud-signals-no-sign-of-a-premium-cut/, stating that on a call with reporters the FHA Commissioner "indicated that despite the positive report, it was still premature to consider a mortgage insurance premium cut in the near term."

[70] FHA Mortgagee Letter 2017-01, *Reduction of Federal Housing Administration (FHA) Annual Mortgage Insurance Premium (MIP) Rates*, January 9, 2017, https://www.hud.gov/sites/documents/17-01ML.PDF.

[71] FHA Mortgagee Letter 2017-07, Suspension of Mortgagee Letter 2017-01 – Reduction of Federal Housing Administration (FHA) Annual Mortgage Insurance Premium (MIP) Rates, January 20, 2017, https://www.hud.gov/sites/documents/17-07ML.PDF.

[72] 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 2017*, pp. 57-58. The FY2018 annual report restated the FY2017 figure for the economic value of the MMI Fund. This would have led to a slightly higher estimated capital ratio of 1.85% with the premium decrease, but it still would have been estimated to have been below 2%.

[73] See 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 2017*, p. 62, for information on the components of the capital ratio for forward mortgages only. Based on these figures, a $3.2 billion decrease in the present value of expected future cash flows attributable to a premium decrease would have reduced the economic value of the forward mortgage

the MMI Fund as a whole is the only number that matters for the purposes of complying with the law. Nevertheless, the estimated impact that the premium decrease would have had on the forward portfolio alone may be relevant to the extent that some are concerned that the inclusion of HECMs in the MMI Fund may affect policy decisions related specifically to the forward portfolio.

FHA-Insured Mortgage Origination Trends Identified by FHA in the FY2018 Annual Report

In the FY2018 annual report to Congress, FHA identified several trends related to the credit quality of its forward mortgage insurance portfolio that it is monitoring due to their potential to increase risk to FHA. In particular, FHA noted the following five trends:[74]

- **Cash-Out Refinances:**[75] Cash-out refinances are refinance transactions in which the borrower can access equity in the home by taking out a new mortgage for a higher amount than the remaining principal balance of the existing mortgage.[76] The share of cash-out refinances insured by FHA has been increasing in recent years, reaching 63% of all FHA-insured refinance mortgages, and 15% of all FHA-insured forward mortgages, in FY2018. The share of cash-out refinances may be increasing for several reasons; for example, rising home prices may lead to more cash-out refinances by increasing borrowers' equity in their homes, and continuing low interest rates may be depressing other types of refinancing activity (making cash-out refinances a larger share of all refinance mortgages). Nevertheless, cash-out refinances have the potential to pose a risk to FHA by increasing borrowers' leverage and reducing the equity they have in their homes. If home prices should fall in the future, it is possible that some borrowers with higher loan-to-value ratios due to cash-out refinances could have difficulty repaying their mortgages.
- **Debt-to-Income Ratios:**[77] Debt-to-income ratios for borrowers with new FHA-insured purchase mortgages have been increasing in recent years. In FY2018, the average debt-to-income ratio for a new purchase borrower was about 43%, compared to 42% in FY2017 and 40% in FY2008. The share of FHA-insured purchase mortgages with borrower debt-to-income ratios above 50% has been increasing as well, reaching nearly 25% in FY2018. Higher debt-to-income ratios

portfolio to $35.2 billion, and an increase of $45 billion in insurance-in-force in the forward portfolio would have resulted in a total of $1,199 billion in insurance-in-force. The capital ratio for forward mortgages alone, then, would have been about 2.94% ($35.2 billion divided by $1,199 billion) rather than 3.33%, all else being equal.

[74] See 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 2018*, pp. 13-14, for FHA's discussion of these trends.

[75] See 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 2018*, pp. 25-26, for data and discussion on FHA-insured cash-out refinances.

[76] The loan-to-value ratio for an FHA cash-out refinance mortgage cannot exceed 85%; that is, the refinanced mortgage cannot be more than 85% of the value of the home. See HUD Handbook 4000.1, Section II.A.8.d.v(B), https://www.hud.gov/sites/documents/40001HSGH.PDF.

[77] See 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 2018*, p. 30, for data and discussion on debt-to-income ratios for FHA-insured mortgages.

could increase the risk that some borrowers might have problems repaying their mortgages if they encounter financial difficulties.

- **Credit Scores:[78]** The average credit scores of borrowers who obtain FHA-insured mortgages have been decreasing since FY2011. In FY2018, the average borrower credit score for FHA-insured mortgages was 670, compared to 676 in FY2017 and 701 in FY2011. This in part reflects a return of FHA to its traditional role in the mortgage market; in the aftermath of the housing market turmoil that began around 2007, FHA insured a greater share of mortgages as mortgage credit conditions tightened, including mortgages for borrowers with higher credit scores who traditionally may not have sought FHA-insured mortgages. As mortgage credit conditions have eased somewhat, more high-credit-score borrowers may find it easier to obtain other types of mortgages. However, lower borrower credit scores could potentially suggest increased risk associated with these mortgages, and FHA has said that it "will continue to monitor declining credit scores for new FHA endorsements for the risk they pose to the MMIF."[79]
- **Down Payment Assistance:[80]** FHA has also been monitoring the increasing share of mortgages that have some form of down payment assistance, and in particular down payment assistance provided by a federal, state, or local governmental entity (rather than other sources, such as a family member). In FY2018, about 38% of FHA-insured purchase mortgages included some type of down payment assistance, compared to about 30% in FY2011. FHA has noted that mortgages with down payment assistance, and down payment assistance provided by a governmental entity specifically, tend to have somewhat higher default rates than other FHA-insured mortgages.[81] FHA has also expressed some concerns about certain types of governmental down payment assistance programs and has suggested that it may be necessary to take action to provide more clarity about what types of down payment assistance are allowed.[82]
- **Nonbank Mortgage Originations:[83]** The share of FHA-insured mortgages originated by nonbanks, rather than by traditional depository institutions, has been increasing in recent years. In FY2018, nonbank lenders originated nearly 87% of new FHA-insured mortgages. While all lenders that originate FHA-insured mortgages are required to meet certain standards, mortgages originated

[78] See 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 2018*, pp. 28-29, for data and discussion of credit scores for borrowers with FHA-insured mortgages.

[79] Ibid.

[80] See 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 2018*, p. 31, for data and discussion on the prevalence of down payment assistance.

[81] See 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 2018*, p. 39, for data and discussion on serious delinquency rates among mortgages with down payment assistance.

[82] See 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 2018*, pp. 91-92, for FHA's discussion of its potential concerns with certain types of down payment assistance programs.

[83] See 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 2018*, p. 32, for data and discussion on nonbank mortgage originations.

- by nonbanks may pose different types of risks to FHA than traditional depository institutions. In its annual report, FHA stated that it "believes it needs to strike a better balance in doing business" with both nonbank and depository lenders.[84]

There are several potential drivers of the trends identified by FHA, including, among other things, economic conditions and the availability of other types of mortgage credit. The overall impact of each of these trends on FHA loan performance and, by extension, its finances will depend on a variety of factors, and some of these trends may pose more of a potential risk to FHA than others.

Author Contact Information

Katie Jones
Analyst in Housing Policy
/redacted/@crs.loc.gov, 7-....

[84] Ibid.