



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HECM Tax & Insurance Default Policy Discussion

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FEDERAL HOUSING ADMINISTRATION



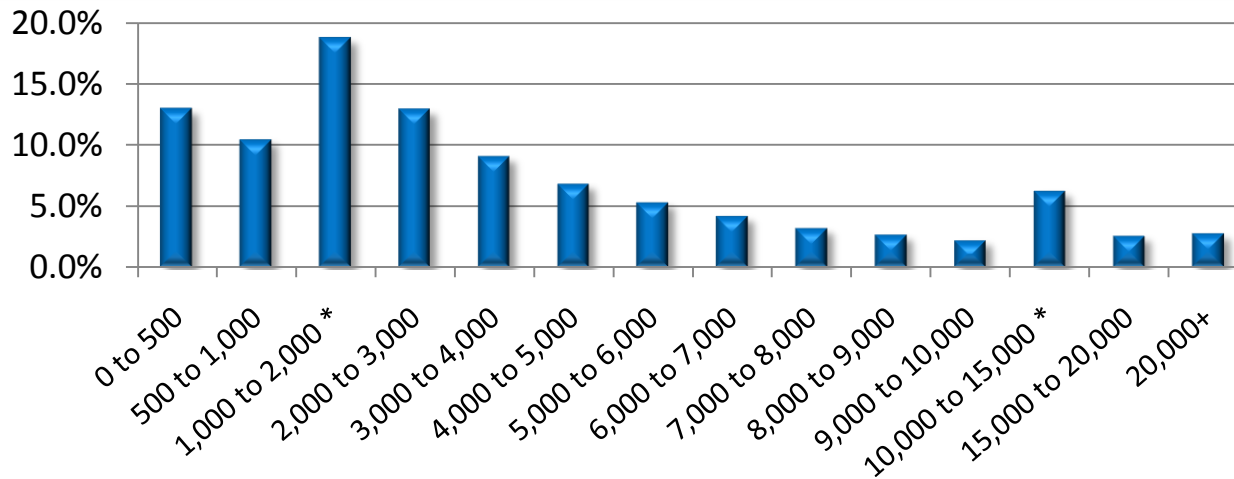
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Tax & Insurance Default Policy

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T&I Defaults – Net Outstanding Corp. Adv. Frequency & Severity



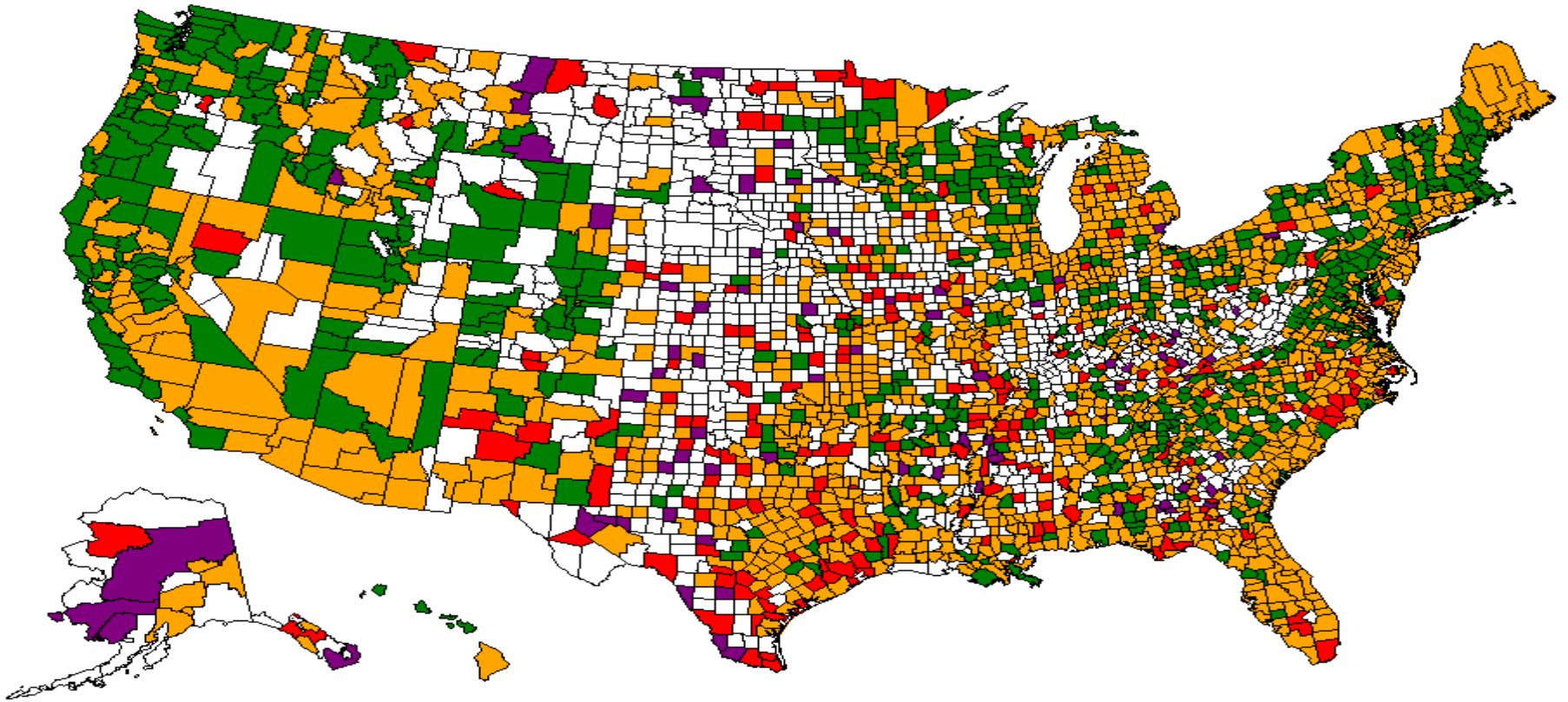
- **Total active T&I Cases = 46,000 with \$209 million in outstanding corp. adv. (8.1% of active loans)**
- Total T&I case count with greater than **\$2,000** in outstanding corp. adv.
 - **26,600 with \$191 million in outstanding corp. adv. (4.7% of active loans).**
- Total T&I case count with greater than **\$10,000** in outstanding corp. adv.
 - **5,300 with \$91 million in outstanding corp. adv. (0.9% of active loans).**
- The mean and median T&I default advance amount is **\$4,800** and **\$2,900** respectfully.
- Reasons for default are balanced for conforming loans –one third each taxes, insurance, and both—but tilt toward taxes only for jumbos (52%), and especially in NY (67%).

Note

- Outstanding Corporate Advances = Total Corporate Advances less Total Repayments
- Bucket range changes start at buckets 1,000 and 10,000
- Data as of July 2011



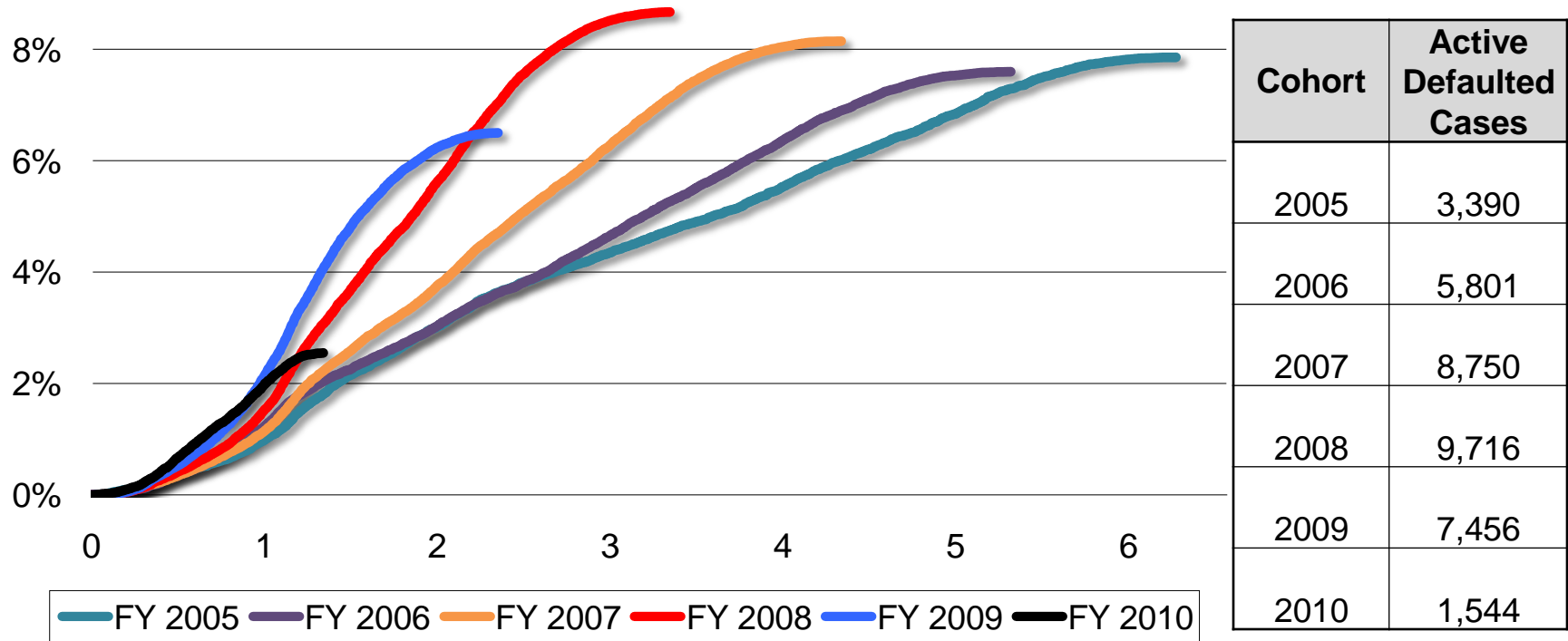
T&I Defaults (All) – Map by County



All Defaults as Percent of Active Loans: ○ 0% ● >0 - 5% ● >5 – 15% ● >15%-30% ● >30%



T&I Defaults (All) – Time Until Default



- The 2008 and 2009 books had 6% of their books in default within 2 years of origination, double the rate of the 2005 and 2006 books.
- The 2010 books fixed rate sub-portfolio default rates are significantly *higher* than the variable rate sub-portfolio.

Note

- All T&I default cases with less than \$500 total corporate advances are removed



T&I Defaults – Reasons for Concern

- Mutual Mortgage Insurance (MMI) Fund is required to maintain a 2 percent capital ratio (loss reserve to protect against unexpected insurance losses).
 - The FY 2009 & 2010 books have required capital infusions from the single family forward reserves.
- Prior to October 4, 2010 the principal limit factors (PLF) used in the HECM program had no allowance for additional losses associated with corporate advances in excess of the principal limit.
- The new Standard and Saver PLFs assume some HECM borrowers will suffer a T&I default but cannot support the current level of defaults within existing books-of-business.
 - The FY 2009 and 2010 books already have over 6 percent and 2 percent of their books in default, respectfully.
- Policy is required to assure new books-of-business experience minimal defaults to stabilize program performance within the MMI Fund.



T&I Defaults – Policy Response

- Reduced original program PLFs by 10 percent in effort to stabilize FY 2010 book-of-business (September 2009).
- Increased premiums, reduced PLFs, and introduced HECM Saver option in effort to stabilize FY 2011 book-of-business (October 2010).
- Issued ML 2011-01 to start active loss mitigation to resolve the currently active defaults (January 2011).
- Issued statement from the desk of the Acting FHA Commissioner informing the industry that there are no prohibitions for underwriting to prevent tax and/or insurance defaults, provided no applicable laws are violated in doing so (October 2011).
- Currently designing policy to identify borrowers, at time of origination, who show a higher propensity to default, which will include underwriting guidelines and some form of financial assessment.
 - Assess borrower cash flow & credit capacity to comply with the terms of the mortgage.



T&I Defaults – Characteristics of Defaulted Borrowers

- Younger (62 – 65) borrowers (origination age) are more likely to default than older borrowers.
- Single males are more likely to default than single females or couples. Couples are the least likely to default.
- Borrowers with home values higher than the area median value (proxy for wealth) are less likely to default than borrowers with home values below median value.
- The probability of default increases through the first four years after origination and then slowly declines over time.
- Borrowers with high initial draws (as a % of IPL) have a higher likelihood of default.
- Borrowers in Florida and Texas have a higher likelihood of default than the rest of the nation. California borrowers have a lower likelihood of default than the rest of the nation.
- Current Constraint: Lack of data to assist in writing policy guidance; request industry to provide data in the public comment period to help shape final policy.



T&I Defaults – Policy Response

- Assess options that could be used as compensating factors to address certain types of risks by providing source of funds to ensure ability to pay property charges.
 - Short term (2 to 3) year property charge set-aside for servicers to use in the event of a default once drawable equity is exhausted.
 - Residual income set-aside, which acts like a tenure stream to provide supplemental income to get the borrower’s debt-to-income ratio below established thresholds and to assist in payment of property charges.
 - Long term (up to life expectancy) property charge set-aside for servicers to use to pay all property charges over the term of the set-aside.
 - Mandatory monthly “escrow type” payments from borrowers.
- FHA Team is working closely with the industry to explore options.
- Some of these approaches will require rule making with public comment period which is a complex and lengthy process.



T&I Defaults – Additional Requirements

- Balance cost and complexity of adding financial assessment with what is required to make a sound assessment of the borrower's ability and willingness to comply with the terms of the mortgage.
- Underwriting data will need to be reported to FHA at time of origination.
- Set-aside options must be integrated into the existing HECM systems and HECM models.
 - Needs to be implementable in current legacy systems at FHA and existing industry operated systems.
 - Needs to respect the design of the program to keep loan balances equal to or under the principal limit.
 - Needs to minimize required system changes to capture set-aside data and changes to the loan balance over time.