

HOUSING
FHA--MUTUAL MORTGAGE INSURANCE FUND
2016 Summary Statement and Initiatives
(Dollars in Thousands)

FHA--MUTUAL MORTGAGE & COOPERATIVE MGMT. HOUSING INSURANCE FUND	Enacted/ Request	Carryover	Supplemental/ Rescission	Total Resources	Obligations	Outlays
2014 Appropriation	\$127,000	\$39,039 ^a	...	\$166,039	\$123,190	\$103,420
2015 Appropriation	130,000	42,849	...	172,849	172,849	143,334
2016 Request	<u>174,000^b</u>	...	...	<u>174,000</u>	<u>172,678</u>	<u>143,069</u>
Program Improvements/Offsets	+44,000	-42,849	...	+1,151	-171	-265

a/ Carryover includes \$34.19 million carried forward into FY 2014 and \$4.85 million of recaptures during FY 2014.

b/ This number includes an estimated transfer to the Transformation Initiative (TI) account of \$1.32 million of budget authority. In addition, the 2016 Budget proposes an administrative support fee estimated to produce \$30 million in offsetting collections. This fee will fund enhancements to FHA Single Family's risk management approach. Such initiatives could include increased quality assurance sampling or implementation of additional tools to ensure optimal asset disposition or the creation of in-house capabilities to model the portfolio's future performance.

1. What is this request?

For fiscal year 2016 the Budget requests \$174 million in support of the Mutual Mortgage Insurance (MMI) Fund, the largest fund covering activities of the Federal Housing Administration (FHA). Since 1934, mortgage insurance provided by FHA has made financing available to individuals and families not adequately served by the conventional private mortgage market. Through MMI, the Department offers several types of single family forward mortgage insurance products and Home Equity Conversion Mortgages (HECMs) for seniors. Activity for the Cooperative Management Housing Insurance (CMHI) Fund – which insures mortgages for multifamily cooperatives – is reported together with MMI.

The fiscal year 2016 Budget request will enable FHA to continue its mission of providing access to mortgage credit for families with low and moderate wealth, and to play an important counter-cyclical role in the continued stabilization and recovery of the nation's housing market. By facilitating the availability of vital liquidity through a variety of HUD-approved lenders, including community banks and national credit unions, FHA has made a number of achievements including:

- Helping over 3.9 million families buy a home since President Obama took office.
- Providing credit access to more than 480,000 first-time buyers in fiscal year 2014, representing over 81 percent of FHA purchase loan endorsements. It is likely that many of these families would otherwise not have been served by the conventional mortgage market.

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- FHA accounted for 47 percent of purchase mortgage financing for Black or African-American and Hispanic borrowers (per 2013 HMDA data).
- The number of first time homebuyers that FHA has supported over the past three years now totals 1.6 million.
- Through its streamline refinance option, FHA helped 115,000 families reduce their monthly housing costs by an average of \$200 per month, for an annual savings of \$2,400 per family.
- FHA also helped more than 477,000 families avoid foreclosure this past year through its loss mitigation home retention servicing tools.

Managing in a challenging mortgage market - FHA’s share of the mortgage market dropped to a low of 3.1 percent of loan originations (by count) in 2005 and then rose to a peak of 21.1 percent in 2009. Since then, FHA’s share of new mortgage originations has come down to under 22 percent. FHA’s core home-purchase loan activity in fiscal year 2014 declined to a level comparable to 2004 (594,997 vs. 586,110 homebuyers, respectively), and was less than the level of FHA activity from 1998 through 2002. FHA’s current market share remains above 1990s levels only because the continuing tight credit market increases the number of underserved borrowers.

In addition to facilitating affordable access to homeownership opportunities, FHA continues to make it a priority to minimize losses to the MMI Fund by assisting homeowners through early delinquency intervention, loss mitigation programs, and specific joint efforts with the Department of Treasury, including: the Home Affordable Modification Program and the FHA Short Refinance program for underwater borrowers with conventional loans. Over fiscal years 2014 and 2015, FHA has 1-year goals of assisting 275,000 homeowners through early delinquency interventions and 110,500 homeowners through loss mitigation programs, with an additional goal of having at least 92 percent of loans receiving this assistance to be current on their mortgages for at least 6 months. For fiscal year 2014, FHA fell slightly short of its early intervention, but far exceeded the permanent loss mitigation program tools utilized, and 499,945 homeowners were assisted in total. Through the end of fiscal year 2014, 92.43 percent of loans that received assistance remained current for at least 6 months.

Performance Indicator	FY14/15 Goal	FY14/15 Outcome
Homeowners assisted through early delinquency intervention (<90 days in default, individual cases)	FY 14: 275,000 FY 15: 275,000	FY 14: 268,266 FYTD 15: 55,503
Homeowners assisted through FHA loss mitigation programs (individual cases)	FY 14: 110,500 FY 15: 110,500	FY 14: 231,679 FYTD 15: 27,579

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The fiscal year 2016 request for MMI includes four components:

- Commitment authority for up to \$400 billion in new loan guarantees. The fiscal year 2016 Budget requests \$400 billion in loan guarantee limitation, which is to remain available until September 30, 2017. This limitation includes sufficient authority for insurance of single family mortgages, mortgages under the HECM program, and the FHA Short Refinance program. Total loan volume projected for all MMI programs for fiscal year 2016 is \$189.0 billion. Of that total, \$173.6 billion is estimated for standard forward mortgages, \$15.1 billion for Home Equity Conversion Mortgages (HECM), and \$300 million for FHA Short Refinances. The size of the request and 2-year availability for this commitment authority reduces the likelihood of program disruption under a continuing resolution or greater than expected volume.
- Negative Subsidy Receipts. The \$189.0 billion in loan volume projected for the entire MMI portfolio in fiscal year 2016 is expected to generate \$6.5 billion in negative subsidy receipts, which are transferred to the MMI Capital Reserve account, where they are available to cover any projected cost increases for the MMI portfolio.
- Appropriations for Administrative Contracts. The Department requests an appropriation of \$174 million, offset by estimated collections of \$30 million from a new administrative fee charged to lenders. The appropriation requested reflects an increase of \$44 million from the fiscal year 2015 appropriation. The additional resources will fund enhancements to administrative contract support, FHA staffing and information technology. The request asks for a transfer of up to \$30 million from this account to the Office of Housing Salaries and Expenses account and the Information Technology Fund. Any funds transferred will be used for FHA salaries and expenses and information technology purposes.
- Commitment authority for up to \$5 million in direct loans to facilitate single family property disposition. The loan authority requested would provide short-term purchase money mortgages for non-profit and governmental agencies. It would enable these entities to make HUD-acquired single family properties available for resale to purchasers with household incomes at or below 115 percent of an area’s median income. This program has been infrequently utilized in recent years due to the shortage of state/local government subsidies needed to offset participant’s development costs associated with administering the program. Nonetheless, the program remains a valuable tool for HUD supporting affordable homeownership opportunities in distressed communities while responsibly managing its real estate owned (REO) inventory of properties.

	2014 Enacted	2015 Enacted	2016 Request	Increase/ Decrease
Loan Guarantee Commitment Limitation	\$400,000,000,000	\$400,000,000,000	\$400,000,000,000	...
Direct Loan Limitation	\$20,000,000	\$20,000,000	\$5,000,000	-15,000,000

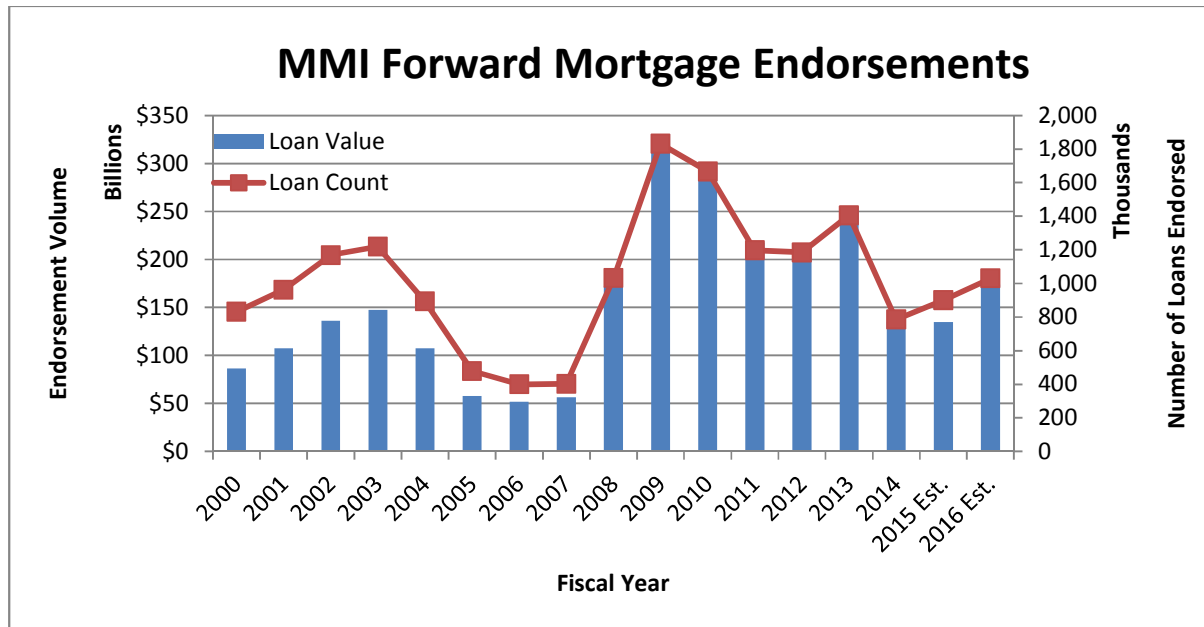
2. What is this program?

FHA has insured over 41 million home mortgages since 1934. In exchange for adherence to strict underwriting and application requirements established by HUD and the payment of insurance premiums, HUD-approved lenders are able to file claims with FHA when a borrower defaults. Mortgage insurance premiums and specific terms for claim payments vary by program. FHA insurance has played a key role in mitigating the effect of economic downturns on the real estate sector, as FHA plays a counter-cyclical role, providing access to mortgage credit during periods of constriction in credit markets. The FHA includes a strong loss mitigation program. Through the recession, FHA has provided key support for the national mortgage market and is mitigating the foreclosure crisis and the overall economic downturn.

As of September 30, 2014, the MMI insurance portfolio included 7.9 million loans with an unpaid principal balance exceeding \$1.1 trillion. FHA mortgage insurance enhances a borrower's credit and provides banks with better access to capital markets, most notably through Ginnie Mae securities. FHA has long been a valuable resource for enabling the purchase of a first home, especially among minority and low-income families. FHA loans are highly attractive to borrowers who are credit-worthy but have difficulty assembling a large down payment or securing conventional financing. In its continuing effort to aid homebuyers, the FHA has announced in January 2015 that it will reduce the annual premiums new borrowers will pay by half a percent. This action is projected to save more than two million FHA homeowners an average of \$900 annually and spur 250,000 new homebuyers to purchase their first home over the next three years.

For budgetary purposes, the programs of the MMI Fund are broken into three risk categories (Forward Mortgages, FHA Short Refinances (Refi), and HECM), each are discussed below:

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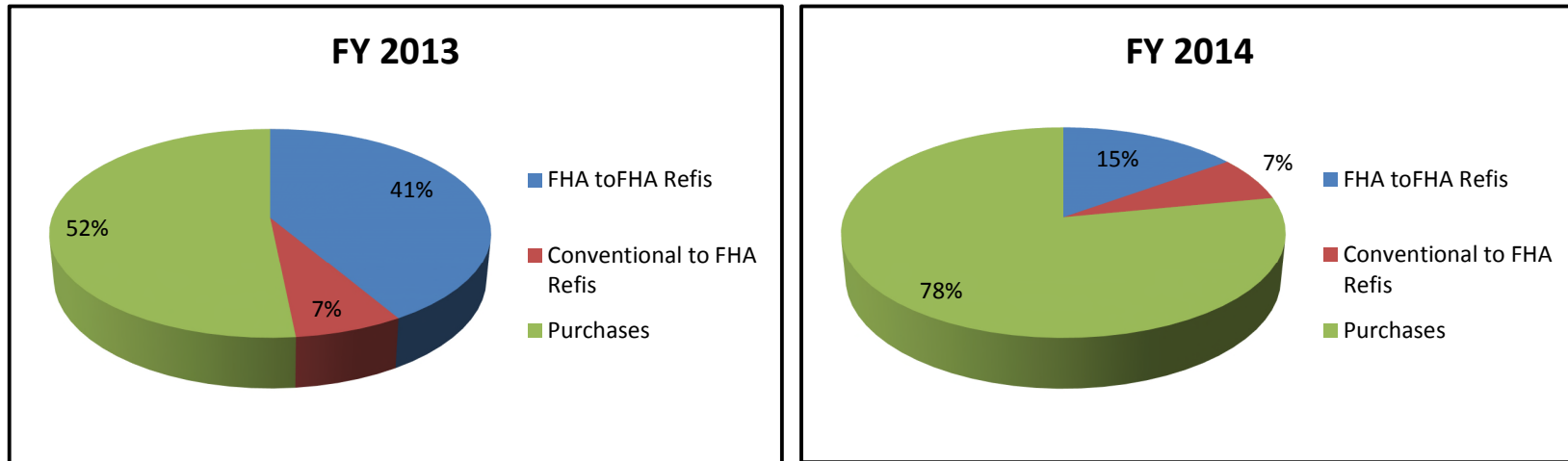


Forward Mortgage Insurance and Guaranteed Loans. Single family programs provide mortgage insurance for the purchase and refinance of homes with one to four units. Loan products under this category include Section 203(b)s, condominiums, homes purchased on Indian and Hawaiian lands, and rehabilitation loans (Section 203(k)). Maximum mortgage amounts insured by FHA are calculated annually by HUD and are generally tied to 115 percent of the median house price in each county.

With 86.3 percent of the total \$148.8 billion in insurance endorsements for the MMI Fund under Section 203(b) during fiscal year 2014, the single family 203(b) program is the largest FHA insurance program authorized under Section 203(b) of the National Housing Act.

FHA endorsement activity peaked in fiscal year 2009, when monthly volume surpassed \$25.8 billion. From this peak, FHA’s annual forward mortgage endorsement volume dropped markedly in 2011 and 2012, but then increased in 2013 because of a large volume of refinance activity. Current estimates show that forward mortgage volume will hold constant at roughly \$135 billion for fiscal years 2014 and 2015, and rising to \$174 billion in fiscal year 2016. The current activity counts for FHA’s core home-purchase business are comparable to levels experienced in the mid-1990s and lower than the experience of the 1998-2002 periods that preceded the recent boom-bust cycle.

203(b) Endorsement Volume by Loan Type



FHA Short Refinance. In fiscal year 2010, HUD and the Department of Treasury announced enhancements to FHA’s refinance program that give a greater number of responsible borrowers the opportunity to remain in their homes. The enhancements were designed to maintain homeownership by borrowers who owe more on their mortgages than the value of their homes with opportunities to refinance into an affordable FHA loan. This program allows a borrower, whose mortgage is current, to qualify for an FHA refinance loan, provided that the lender or investor writes off the unpaid principal balance of the original first lien mortgage by at least 10 percent. FHA will accept applications for this program through the end of calendar year 2016.

HECM. FHA’s HECM program provides senior homeowners age 62 and older access to FHA-insured reverse mortgages which enable seniors to access equity in their homes to support their financial and housing needs as they age. The HECM program fills a special niche in the national mortgage market and offers critical opportunities for the nation’s seniors to utilize their own assets and resources to preserve their quality of life. The HECM program provides options to seniors to access their equity through monthly payments, draws from a line of credit, or one-time draw at close. Unlike a forward mortgage, the HECM borrower does not make payments on the loan and the loan does not become due and payable until the last remaining mortgagor no longer occupies the property or fails to comply with other requirements of the loan such as payment of property taxes and insurance.

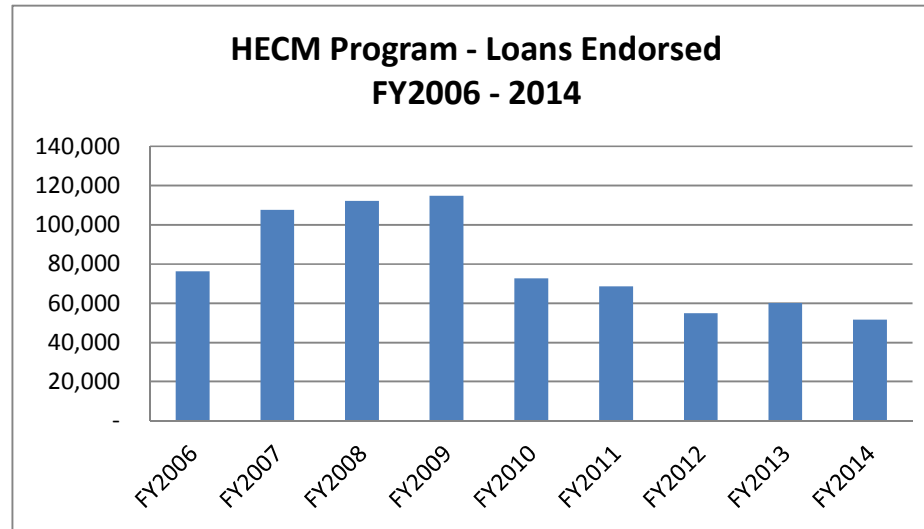
During the housing crises, seniors were significantly impacted by the recession and falling home prices and, as with Forward Mortgages, risk to the MMI Fund increased. Since the passage of the Reverse Mortgage Stabilization Act in 2013, FHA has implemented several changes to strengthen and enhance the HECM program. These changes include limiting upfront draws, changes to the mortgage insurance premium structure to encourage lower initial draws and a shift to Adjustable Rate HECMs which encourage borrowers to access funds as they need them, preserving equity to support them over time. Effective March 2, 2014 a

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Financial Assessment will be required for all HECM Mortgages. This is a similar process to the underwriting which is required for Forward mortgages, but emphasis is on analyzing the HECM borrower's ability and willingness to pay the required property taxes and insurance and to determine if the HECM is a sustainable solution for the senior. Additional changes were implemented in August, 2014 to address litigation risk related to non-borrowing spouse issues for new HECM originations; additional changes are scheduled for publication in 2015 to expand alternative solutions for HECMs with case numbers assigned prior to August 4, 2014.

There are many studies that highlight the impact that increased longevity, rising health care and other costs, fewer defined benefit pension programs and diminished investment values have had on senior's income and savings. HECMs provide a viable option to access equity in their homes. Due to the housing crises and lack of available private sector products, FHA has provided a critical counter-cyclical role in this market, as it has with Forward loans, providing access to credit for seniors.

Since the program inception in 1989 through fiscal year 2014, FHA has endorsed 890,693 loans. Volume increased significantly from 2005 to 2009. Since then, endorsements have declined from a high of 114,640 to an estimated 51,617 in fiscal year 2014. This decline in production reflects market pressures and FHA policy changes that better manage risk and ensure the program is sustainable for seniors.



The HECM program was introduced as a "demonstration" program in 1987 and became a permanent HUD program in 1998. Eventually in 2006 a statutory aggregate cap of 275,000 HECM loan guarantees was put in place. It has been necessary to lift this cap on an annual basis through the appropriations process. In addition to requesting commitment authority for HECM, the Budget will again propose permanently lifting the cap of 275,000 loan guarantees to provide further stability for the HECM program. This

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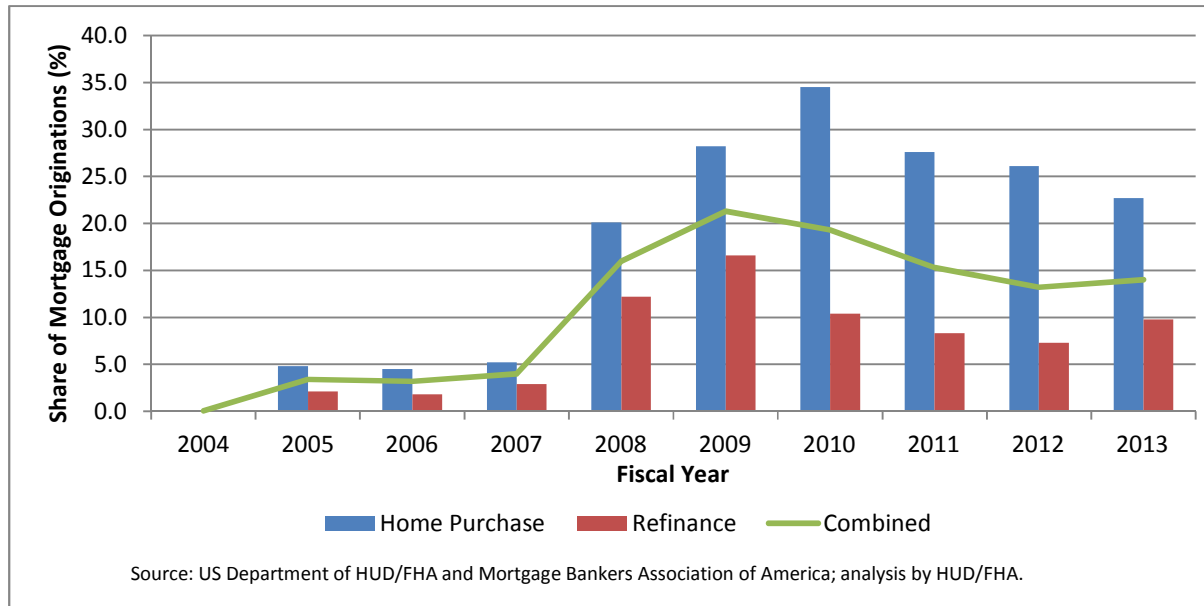
change supports the significant improvements that have been made to the program to reduce risk to the MMIF and to ensure responsible lending to seniors.

The January 2015 reduction of annual MIP levels by 0.5 percent for single family FHA loans with terms greater than 15 years contributes to home affordability and therefore is expected to drive more volume to FHA in the short-term. The reduction in annual MIP was possible due to the aggressive risk management actions taken over the last several years. With over \$21 billion in economic net worth created over the last two year, and improvements in key metrics such as seriously delinquent rates, recovery rates and foreclosure starts, the fund is on a positive trajectory.

3. Why this program is necessary and what will we get for the funds?

FHA provides mortgage insurance on single family mortgage loans made by FHA-approved lenders throughout the United States and its territories. FHA's single family mortgage insurance program supports our nation's housing recovery by meeting the needs of borrowers facing difficult economic conditions, such as declining property values and shrinking credit markets. FHA remains active and viable in all markets during times of economic disruption, playing an important counter-cyclical role until private capital returns to its normal levels. FHA will continue to meet the needs of many first time and minority homebuyers who—without the FHA guarantee—may otherwise find mortgage credit to be prohibitively costly or simply unavailable.

**FHA Supports Mortgage Lending During Crisis
FHA As Share of Quarterly Mortgage Originations by Type (Percent)**



Commitment Authority and Subsidy Projections

The fiscal year 2016 Budget request will provide the commitment authority and administrative funding for FHA to continue its important work.

Below is a table indicating loan commitment volumes, credit subsidy rates, and subsidy obligations for each MMI risk category in fiscal years 2015 and 2016. Credit subsidy rates represent the projected net cost (positive credit subsidy) or savings (negative credit subsidy) to the government of operating a loan guarantee program, and take into account projected claims, pre-payments, premium revenue, and recoveries on defaults for a cohort of loans over their lifetime. For more information on credit subsidy calculation please see the Notes section.

Estimates of single family commitment volume are calculated using both empirical inputs such as recent loan application volume and endorsement trends, as well as a variety of assumptions regarding expected condition in the housing and credit markets, interest rates, historic seasonal adjustment, and anticipated effect of program changes. These estimates are also very sensitive to other

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factors that cannot be readily anticipated or predicted, such as economic or fiscal policy changes. Even model variations in market trends or economic assumptions can result in significant changes in actual program demand and commitment volume.

MMI COMMITMENT VOLUME BY RISK CATEGORY (in millions)	FY 2014 Endorsements	FY 2015 Estimate	FY 2015 CSR	FY 2015 Subsidy Receipts	FY 2016 Estimate	FY 2016 CSR	FY 2016 Subsidy Receipts
MMI Purchase and Refinance	\$135,087	\$134,707	-6.58%	(\$8,864)	\$173,600	-3.70%	(\$6,423)
MMI HECM	13,534	15,860	-0.40%	(63)	15,138	-0.69%	(\$104)
FHA Short Refinance	192	300	0.00%	...	300	0.00%	...
Totals	\$148,813	\$150,867	-5.92%	(\$8,927)	\$189,038	-3.45%	(\$6,527)

Administrative Contract Appropriations

The \$174 million request for fiscal year 2016 will provide funding for contracts necessary in the administration of FHA programs, operating under MMI and GI/SRI. This request will fund activities including, but not limited to: insurance endorsement of Single Family mortgages, construction inspections on multifamily projects, the required annual FHA independent actuarial review and financial audit, management and oversight of asset disposition, risk analysis, accounting support, and assistance with claims and premium refund processing. The \$44 million increase over the fiscal year 2015 appropriation is needed to fund improvements in risk management and mitigation. These new and expanded initiatives will allow FHA to incorporate lessons learned from the recent financial crisis to better protect the insurance fund and further promote operational efficiencies through the leveraging of tools to ensure optimal level asset disposition pricing; leveraging of vendors to ensure appropriate depth and breadth of Quality Control reviews; and development of risk analytics and modeling capabilities independent of actuarial review.

The benefits to be derived from these initiatives include the ability to: 1) appropriately set reserve prices to ensure optimal outcome whether a short sale, claims without conveyance of title, or REO disposition path is chosen; 2) leverage an external quality control vendor to add re-verification processes and absorb variations in quality control sample sizes without taxing our already limited staff; 3) analyze portfolio risk, leverage external research and data on market trends, and enable more comprehensive and rapid policy change analysis in response to changing market dynamics; and 4) improve recovery rates for defective loans.

These initiatives are explained in detail below.

Quality Assurance/Compliance

FHA relies on private-sector lenders and servicers to underwrite and service endorsed loans. Occasionally, these lenders and servicers have operational failures that increase the likelihood of default and, thus, the likelihood of FHA having to pay a claim. When FHA detects a major operational failure, FHA generally requests that the associated lender or servicer to indemnify the MMI Fund for

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any claims paid or seeks other enforcement actions against that lender or servicer. FHA detects these failures through its quality-control and quality-assurance programs; wherein FHA reviews a subset of loan files, looking for errors made by its lenders and servicers. Over the past few years, FHA has significantly improved its enforcement policies and practices.

FHA's lenders and servicers work hard to avoid major operational failures, because indemnifying FHA for losses is very costly; however, some instances of failure will always remain. As such, because FHA's quality assurance efforts are focused on primarily defaulted loans, lenders curtail the amount they lend to high-risk populations to mitigate potentially higher indemnification costs. Unfortunately, it is precisely those high-risk populations that FHA seeks to help in fulfilling its mission to provide affordable housing to those most in need.

Earlier feedback on a statistically relevant sample of non-adverse loans will ensure that FHA understands the loan quality risk embedded in its portfolio before loans start to default and allow lenders to take actions to resolve operational issues contributing to loan quality issues before they build up several years' worth of exposure.

Currently, FHA has the capacity to review approximately 35,000 loans annually. This capacity is distributed largely to a risk-based sample of early defaulted loans. FHA believes it must increase its capacity to approximately 100,000-150,000 loans annually to ensure sufficient early reviews of a statistically relevant sample of endorsed loans, as well as still sampling early defaulted loans which are more likely to have defects. Without increased funding, FHA sampling will not be able to increase at the level needed for robust risk management.

Portfolio Analytics

As FHA works to improve and strengthen its capability for detecting and mitigating front and back end portfolio risks, access to timely and decision useful data is key. Essential to FHA's risk management strategy is its ability in fiscal year 2016 to procure comprehensive services and tools that allow the Office of the Chief Risk Officer to model risk at the portfolio levels and to perform data analysis to identify key credit risk drivers, segmentation profiles and emerging trends in credit and operational risk. In addition, the future state of FHA's risk and fraud detection business environment calls for continuing work on the integration of FHA's risk and fraud tools with its credit score card. The benefits to be derived from these services include improved cash flow projections, better accuracy in budget inputs and subsidy modeling, reduced claims against the capital reserve and informed executive decisions and policies that are supported by healthier data.

Automated Valuation Model (AVM) and Broker's Price Opinion (BPO) to support Real Estate Owned (REO) Property Values

Traditionally, the Federal Housing Administration's (FHA) initial list price for its real estate-owned (REO) property is based solely on an appraisal. Based on discussions with other stakeholders, FHA has learned that other market holders of REO properties establish the list price of their REO properties based on at least two valuation tools (Appraisal and/or Automated Valuation Model (AVM) , Broker's Price Opinion (BPO), etc.). FHA has conducted pilots in the Santa Ana Homeownership Center (HOC) and the Atlanta HOC

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to test the price variance by establishing the list price of their REO properties based on at least two valuation tools, and initial results indicate that in certain markets, appraisals are lagging the market, which has resulted in FHA not maximizing its recovery rates. The pilots have resulted in offers of approximately 104 percent of appraised value, compared to 93 percent nationally. This suggests that expanding these tools and approach could lower losses to MMIF significantly, perhaps by as much as 10 percent for REO dispositions.

4. How do we know this program works?

FHA single family insurance is known to work, not only because it provides a counter-cyclical backstop, but also because it: 1) increases liquidity for mortgage lending, including mortgage lending for low wealth families; 2) serves as a primary source of mortgage credit for minority and first time homebuyers; and 3) has key features that provide consumer protections that were lacking in much of the private lending leading up to the mortgage market collapse.

FHA continuously monitors and evaluates the results of its programs and updates its policies as necessary, taking into consideration product performance as well as market forces. To address current and difficult conditions in the housing market, aid homeowners, and mitigate risk to FHA's insurance fund, FHA develops new programs, modifies existing programs and improves controls. For example, in 2014 FHA made significant changes to its HECM program as described above, updated its manual underwriting requirements for forward mortgages and updated requirements for pre-foreclosure sales and deeds-in-lieu, steps that raised negative subsidy receipts and helped restore FHA's capital reserve.

FHA continued to support distressed homeowners in 2014 by implementing scorecards to assess and monitor servicers' effectiveness in working with these homeowners consistent with FHA loss mitigation policies. In 2014, FHA assisted over 250,000 homeowners through early delinquency intervention; re-defaults on modified loans were less than 10 percent. However, when it is not possible for homeowners to retain their homes under FHA guidelines, FHA has expanded use of its Distressed Asset Sale pilot Program to sell notes to other investors who may be able to provide alternative loss mitigation options or other strategies for homeowners. In 2014, FHA also expanded its use of Claims without Conveyance of title, an approach that ensures a competitive sale at time of foreclosure and allows the servicer to file a claim without conveying the property. This results in reduced expenses, more favorable recoveries for the MMI Fund and supports neighborhoods by limiting the number of vacant properties in the area.

Strengthening FHA's Capital Reserves

HUD continues to strengthen the MMI Fund and improve the quality of endorsements through the implementation of a number of policy changes in 2014. These include:

- REO and Pre-REO recovery - Through the Distressed Asset Stabilization Program (an expanded and targeted version of the Mortgage Acquisition and Disposition Initiative (601 Notes Sales)), FHA has implemented a successful strategy to increase

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REO recovery rates and limit losses to the MMI Fund. In fiscal year 2014, HUD offered approximately 66,800 non-performing loans in competitive sales with a combined unpaid principal balance of \$11 billion. Of the loans offered, approximately 8,500 loans, with a combined unpaid principal balance of \$1.60 billion, were offered with neighborhood stabilization requirements in Atlanta, California, Chicago, Cumberland County, NJ, Detroit, Indianapolis, Las Vegas, Maryland, Miami, Philadelphia, and San Antonio.

- FHA is also utilizing other innovative strategies, including expanding a pilot program Claims without Conveyance of Title (CWCOT) into a broad-based effort whereby foreclosed properties are sold and a claim paid by FHA without the conveyance of these properties to FHA. These strategies build upon FHA's success in improving its REO disposition process, and, together with FHA's work to comprehensively address asset management and disposition, will have a measurable impact on improving loss severities arising from non-performing FHA-insured loans.

On July 30, 2013 Congress enacted P.L. 113-29, the Reverse Mortgage Stabilization Act of 2013, to authorize the Secretary of Housing and Urban Development to establish additional requirements to improve the fiscal safety and soundness of the HECM program. As a result, several changes utilizing this authority and existing administrative authority have been made to the program. These measures include:

- Capping draws in the first year to the greater of 60 percent of the principal limit or mandatory obligations plus 10 percent of the principal limit;
- Replacing the Standard and Saver principal limit factors (PLFs) with a single set of PLFs set at 85 percent of the baseline Standard PLFs;
- Replacing the Standard and Saver upfront mortgage insurance premiums (MIPs) with a two-tiered MIP structure set at 50 basis points (bp) for draws of 60 percent or less of the initial principal limit and 250 bp for draws greater than 60 percent;
- Updating the definition of mandatory obligations;
- Requiring financial assessments and funding requirements for the payment of property charges based on the financial assessment;
- Reminding industry about prohibitions against misleading or deceptive advertising;
- Implementing updated Principal Limit Factors and establishing Eligible Non-Borrowing Spouse Due and Payable deferral period; and
- Limiting insurability of fixed interest rate products and limiting fixed rate to closed end credit with no future draws.

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In total, FHA expects that the steps outlined above will protect and strengthen FHA's MMI Fund and assist in returning the Fund's capital ratio to a level of 2 percent. The 2014 actuarial review predicted that based on economic assumptions and policies in place at the end of fiscal year 2014, the MMI portfolio will reach a capital ratio of 2 percent during fiscal year 2016. This estimate, however, is highly sensitive to changes in market conditions, modeling assumptions and changes in FHA policy. As the housing market recovers and FHA improves its risk management, the actuarial review has found that FHA's capital reserve increased by \$21 billion over the last two years and projects that the ratio will again exceed 2 percent within the next 2 years. However, it is important to note that a low capital ratio does not threaten FHA's operations, either for its existing portfolio or for new books of business. FHA accounts contain sufficient funds to pay anticipated claims and, unlike private lenders, the guarantee on FHA and other Federal loans is backed by the full faith and credit of the Federal Government and is not dependent on capital reserves to honor its commitments.

Housing Counseling as a Means of Increasing Sustainable Access to Credit and Protecting the MMIF

The HUD-approved housing counseling network provides a valuable service to existing and prospective homebuyers. These benefits include improved loan performance as counseled borrowers perform better than similar borrowers that do not receive the benefit of housing counseling. There is strong and mounting evidence that properly structured and delivered housing counseling provides a significant benefit to borrowers, lenders, servicers and guarantors. The HUD approved housing counseling network is also leveraged by many state and local governments. In response, many states, local governments and large private lenders mandate or encourage housing counseling including making receipt of housing counseling a condition for participation in programs that increase access to home mortgages, including FHA insured mortgage loans, for eligible first-time buyers underserved by the current mortgage market.

While counseling is already integrated into FHA's HECM program and a component of its Back to Work mortgage product, in 2016, FHA will look for opportunities to increase the awareness of housing counseling for all prospective and existing homebuyers. In addition, it will look for opportunities to expand the number of people benefiting from housing counseling, including the number of FHA borrowers who are counseled.

Strengthening FHA Business Practices – FHA Transformation IT Investments

FHA Transformation delivers a modern financial services IT environment to better manage and reduce risk across all of FHA's Mortgage Insurance Programs. FHA Transformation TI/IT initiative created high-level business requirements and developed both short and long term FHA master data management roadmaps and strategies; completed permanent development and user acceptance test environments for the Lender Electronic Application Portal (LEAP) deployment, and future work within approval, recertification, monitoring, and enforcement; completed permanent integration test and production environments for LEAP for application deployment and future work ,as well as, successfully graduating the LEAP application into production.

FHA activities also include the automation of the lender application and approval process, lender submission of applications, Office of Lender Activities workflow, status tracking, automatic notifications, automated application assignment to FHA staff for review, and interface with third party Dun & Bradstreet for lender profile information and verification. FHA Transformation also made sound

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progress on the transformation of Single Family Housing's IT systems and its new risk management tool. Notably, HUD has made critical enterprise software and infrastructure investments for FHA that reduce maintenance costs once the FHA Transformation initiative is completed.

FHA Transformation allows HUD to start the careful process of migrating relevant portions of Housing's legacy applications into a modern automated financial service environment, and helps administer many aspects of the multifamily and health care insurance programs. Particularly, the FHA Transformation monitoring and enforcement projects allow the Office of Lender Activities to automate many current manual processes.

FHA Transformation also brings a new level of intelligent rules-based activities such as automated risk analysis and lender targeting according to a risk scoring framework. This helps HUD manage its credit risk prudently at the portfolio and loan level, and enables HUD to respond rapidly to changing market conditions. The new IT environment will be leveraged across several Housing programs by migrating away from the 30-year old Computerized Home Underwriting Management System (CHUMS). These FHA Transformation initiatives enable FHA to better recognize risk and fraud trends in borrower attributes, collateral attributes, and appraisal valuation accuracy during the transaction process, and to help identify cases that may be detrimental to the MMI Fund.

The next steps for FHA Transformation include enabling risk detection and fraud prevention by capturing critical data points at the front-end of the loan life cycle; and leveraging the right set of rules-based technology, and transactional controls to minimize exposure to FHA's Insurance Funds. These IT investments actively facilitate enhanced business analytics and informed decision-making by providing decision-makers with data that is higher quality and more up-to-date. This strategy enables FHA's leadership to analyze portfolio trends and patterns across the lending community, and helps with the identification of fraudulent lenders and reduce risk in the FHA portfolio.

Risk Management

The major objective of the Office of Risk Management and Regulatory Affairs (ORMRA) is to: conduct analysis and recommend actions to reduce exposure to FHA insurance funds while meeting its housing mission; ensure that FHA operates in compliance with statutory capital requirements; and promote a well-controlled operational infrastructure. The risk management staff's scope of credit and operational risk management work encompasses Program Area (Single Family, Multifamily and Healthcare) activities conducted at headquarters and the Field Offices.

ORMRA performs the following functions to manage risk:

- performs analyses and recommends actions to support FHA's ability to reduce risk exposure to its insurance funds;
- identifies the policies and processes that are key drivers of risk via a structured risk identification framework;

Mortgage and Loan Insurance Programs – MMI/CMHI Account

- recommends risk mitigation strategies for FHA and specific program areas and provide independent oversight and assessment of risk remediation activities;
- designs and maintains a comprehensive risk governance infrastructure, including implementing policies, processes, and committees to reduce risk exposure to the insurance funds;
- maintains risk management processes to perform independent internal risk and assessments aligned with federal standards, including front end risk assessments of new and high impact programs and activities; and
- ensures that risks are measured, monitored and managed according to an integrated framework across programs.

5. Proposals in the Budget

- Administrative Support Fee – Up to \$30 million in fees to be charged to lenders pursuant to section 202 of the National Housing Act, as amended by section 240 of the General Provisions. Collection of the receipts from such fees will be credited as offsetting collections to the MMI Program account. Up to \$15 million of the total fees may be transferred to the Information Technology Fund and/or the Housing Salaries & Expenses account to be used for FHA related purposes. (section 240 of the General Provisions and account language)
- Permanent Removal of HECM cap – (section 209 of the General Provisions) This provision removes the aggregate mortgage cap in Section 255(g) of the National Housing Act (Act), which limits the total number of Home Equity Conversion Mortgages (HECM) loans that can be insured by the FHA. The Department proposes to repeal the first sentence in the Act to remove the cap permanently.
- Clarification on Non-Borrower Spouse Upon Death of HECM Borrower – (section 255 of the General Provisions) This section revises the National Housing Act to clarify that the term mortgagor does not include the successors and assigns of the original borrower. In addition, it allows that the obligation to satisfy the loan is deferred until the death of the homeowner, the sale of the home, or other occurrence of other events specified in regulations of the Secretary. Finally, it provides for the Secretary, in his sole discretion, to provide for further deferrals.
- Amend the National Housing Act to allow third party loan originators to close loans in their own name instead of the name of their FHA approved funding partner – (section 248 of the General Provisions) The inability of non-approved entities to close loans in their names poses a number of problems for these lenders. First, many states' licensing criteria for particular lender types is based upon whether or not a lender closes loans in its own name. As a result, absent a change to this statutory requirement, many lenders that have originated FHA loans for years will be forced to alter their state licensing. Such changes can be difficult and costly. In addition to the licensing problems posed by the statutory prohibition in 203(b)(1), many lenders will also be forced to change their funding arrangements if this statute is not amended

Mortgage and Loan Insurance Programs – MMI/CMHI Account

- Amend the National Housing Act to enable FHA to take enforcement action against lenders on a nationwide instead of branch by branch termination authority – (section 249 of the General Provisions) Amends section 533 of the National Housing Act (12 U.S.C. 1735f-11) to give the Secretary enhanced ability to review mortgagee performance and, if a mortgagee is found to have an excessive rate of early defaults or claims, to terminate the approval of the mortgagee to originate or underwrite single family mortgages in a specified area or areas, or on a nationwide basis.
- Amend Credit Watch language to allow for a comparison of rates and revises the rate provision to allow for some evaluation of multiple rates or other marker – (section 249 of the General Provisions) The current statutory definition of credit watch is too prescriptive, creating difficulties in developing and implementing policies. This requested language is also included in the enforcement reform item.
- Allow FHA to seek indemnification from DE lenders in addition to LI Lenders – (section 250 of the General Provisions) This has been included in FHA Reform Efforts. This language will make all FHA lenders subject to the same enforcement regime. Section 3 amends section 202 of the National Housing Act (12 U.S.C. 1708) by adding a new section that gives FHA/the Secretary authority to ensure that DE (similar to LI) mortgage lenders are liable to indemnify the Secretary for loss on loans they originate or underwrite if fraud or misrepresentation was involved in connection with the origination or underwriting regardless of when an insurance claim is paid.
- Revises the National Housing Act to allow for short sales in the case of imminent and not just actual default – (section 252 of the General Provisions) Currently FHA is only able to allow for pre-foreclosure/short sales if a borrower has entered into default, creating a negative disincentive for homeowners having trouble making their mortgage payments and seeking a loss mitigation solution.
- Limit the applicability of government financed down payment assistance towards satisfying FHA requirements – (section 253 of the General Provisions) This amendment seeks to clarify that Down payment Assistance from state and local governments and their respective agencies and instrumentalities are not impermissible sources of down payment assistance. Rather the amendment clarifies Congress's intent to avoid the additional risks and costs to the FHA fund created by seller-funded down payment assistance programs and, consequently, eliminates government assistance, whether state or local, as a prohibited source of down payments assistance.
- Allow for FHA to direct servicers to move servicing to identified sub-servicers – (section 254 of the General Provisions) Failure to effectively service loans creates liability for the FHA insurance fund; as such, FHA needs the ability of direct servicers to utilize identified sub-servicers to ensure that loans are appropriately serviced in ways that mitigate loss levels for the Fund.
- Mitigate compliance risk through the extrapolation of sampling, Administrative fees, indemnifications and other risk mitigation remedies – (section 251 of the General Provisions) Allows FHA to resolve underwriting/manufacturing

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compliance risk through the extrapolation of statistical sampling and the imposition of administrative fees, indemnifications or other remedies as deemed appropriate by the Commissioner.

6. Notes to Justification

Credit Subsidy Calculations and the Annual Re-estimate

Credit subsidy rates represent the projected net cost or savings to the government of operating a loan guarantee program, and take into account projected claims, pre-payments, premium revenue, and recoveries on defaults for a cohort of loans over their lifetime. In accordance with the Credit Reform Act of 1990, administrative costs (excluding property disposition) are not included in credit subsidy calculations. FHA credit subsidy rates reflect historic performance data for similar loans made over the past 40 years, with adjustments made for significant policy shifts as well as changing economic and market conditions. The Department devotes significant efforts to updating and continuously refining the credit subsidy estimates. Each year the extensive statistical base, from which projections of future loan performance are calculated, is updated with an additional year of actual data. The Department and OMB continue to examine the data, assumptions, and calculations that are used to estimate loan program cash flows and subsidy rates in order to eliminate errors and improve the accuracy and reliability of projections.

Each year, FHA completes a required re-estimate of liabilities and subsidy costs associated with the existing insurance portfolio. Re-estimates are calculated for each cohort of loans (from 1992 onward). For more information on the re-estimates through 2014, please view the Federal Credit Supplement: <http://www.gpo.gov/fdsys/pkg/BUDGET-2014-FCS/pdf/BUDGET-2014-FCS.pdf>

Mortgage and Loan Insurance Programs – MMI/CMHI Account

HOUSING
FHA – MUTUAL MORTGAGE INSURANCE FUND
Summary of Resources by Program
(Dollars in Thousands)

<u>Budget Activity</u>	<u>2014 Budget Authority</u>	<u>2013 Carryover Into 2014</u>	<u>2014 Total Resources</u>	<u>2014 Obligations</u>	<u>2015 Budget Authority</u>	<u>2014 Carryover Into 2015</u>	<u>2015 Total Resources</u>	<u>2016 Request</u>
Administrative Contract Expense	\$127,000	\$39,039	\$166,039	\$123,190	\$130,000	\$42,849	\$172,849	\$174,000
Transformation Initiative (transfer)	...	...	...	...	...	...	...	[1,322]
Total	127,000	39,039	166,039	123,190	130,000	42,849	172,849	174,000

HOUSING
FHA – MUTUAL MORTGAGE INSURANCE FUND
Appropriations Language

The fiscal year 2016 President's Budget includes proposed changes in the appropriation language listed and explained below. New language is italicized and underlined, and language proposed for deletion is bracketed.

New commitments to guarantee single family loans insured under the Mutual Mortgage Insurance Fund shall not exceed \$400,000,000,000, to remain available until September 30, ~~[2016]~~ 2017. *Provided*, That during fiscal year ~~[2015]~~ 2016, obligations to make direct loans to carry out the purposes of section 204(g) of the National Housing Act, as amended, shall not exceed ~~[\$20,000,000]~~ \$5,000,000. *Provided further*, That the foregoing amount in the previous proviso shall be for loans to nonprofit and governmental entities in connection with sales of single family real properties owned by the Secretary and formerly insured under the Mutual Mortgage Insurance Fund.

*[Provided further, That f] For administrative contract expenses of the Federal Housing Administration, ~~[\$130,000,000]~~ \$174,000,000, to remain available until September 30, ~~[2016]~~ 2017, of which up to \$30,000,000 may be used for necessary salaries and expenses and information technology systems of the Federal Housing Administration, which is in addition to amounts otherwise provided under this title for such salaries and expenses and information technology purposes: Provided further, That any amounts to be used for such salaries and expenses pursuant to the previous proviso shall be transferred to the "Housing" account under the heading "Program Office Salaries and Expenses" under this title for such purposes and shall remain available until September 30, 2017, and any amounts to be used for such information technology purposes pursuant to the previous proviso shall be transferred to the Information Technology Fund under this title for such purposes and shall remain available until September 30, 2017, and any such transferred amounts may be transferred back to this account and shall remain available until September 30, 2017: Provided further, That to the extent guaranteed loan commitments exceed \$200,000,000,000 on or before April 1, ~~[2015]~~ 2016, an additional \$1,400 for administrative contract expenses shall be available for each \$1,000,000 in additional guaranteed loan commitments (including a pro rata amount for any amount below \$1,000,000), but in no case shall funds made available by this proviso exceed \$30,000,000: *Provided further, That receipts from administrative support fees collected pursuant to section 202 of the National Housing Act, as amended by section 240 of this title, shall be credited as offsetting collections to this account.* (Department of Housing and Urban Development Appropriations Act, 2015.)*

**HOUSING
GENERAL AND SPECIAL RISK INSURANCE FUND
2016 Summary Statement and Initiatives
(Dollars in Thousands)**

FHA--GENERAL AND SPECIAL RISK INSURANCE FUND	<u>Enacted/ Request</u>	<u>Carryover</u>	<u>Supplemental/ Rescission</u>	<u>Total Resources</u>	<u>Obligations</u>	<u>Outlays</u>
2014 Appropriation	\$16,403	...	\$16,403	...	...
2015 Appropriation	16,408	-\$10,000 ^a	6,408	...	...
2016 Request	<u>...</u>	<u>6,408</u>	<u>...</u>	<u>6,408</u>	<u>...</u>	<u>...</u>
Program Improvements/Offsets	-10,000	+10,000	...	...	...

a/ The rescission of funds from the unobligated balance of credit subsidy appropriated in previous fiscal years, pursuant to the Consolidated and Further Continuing Appropriations Act, 2015 (P.L. 113-235).

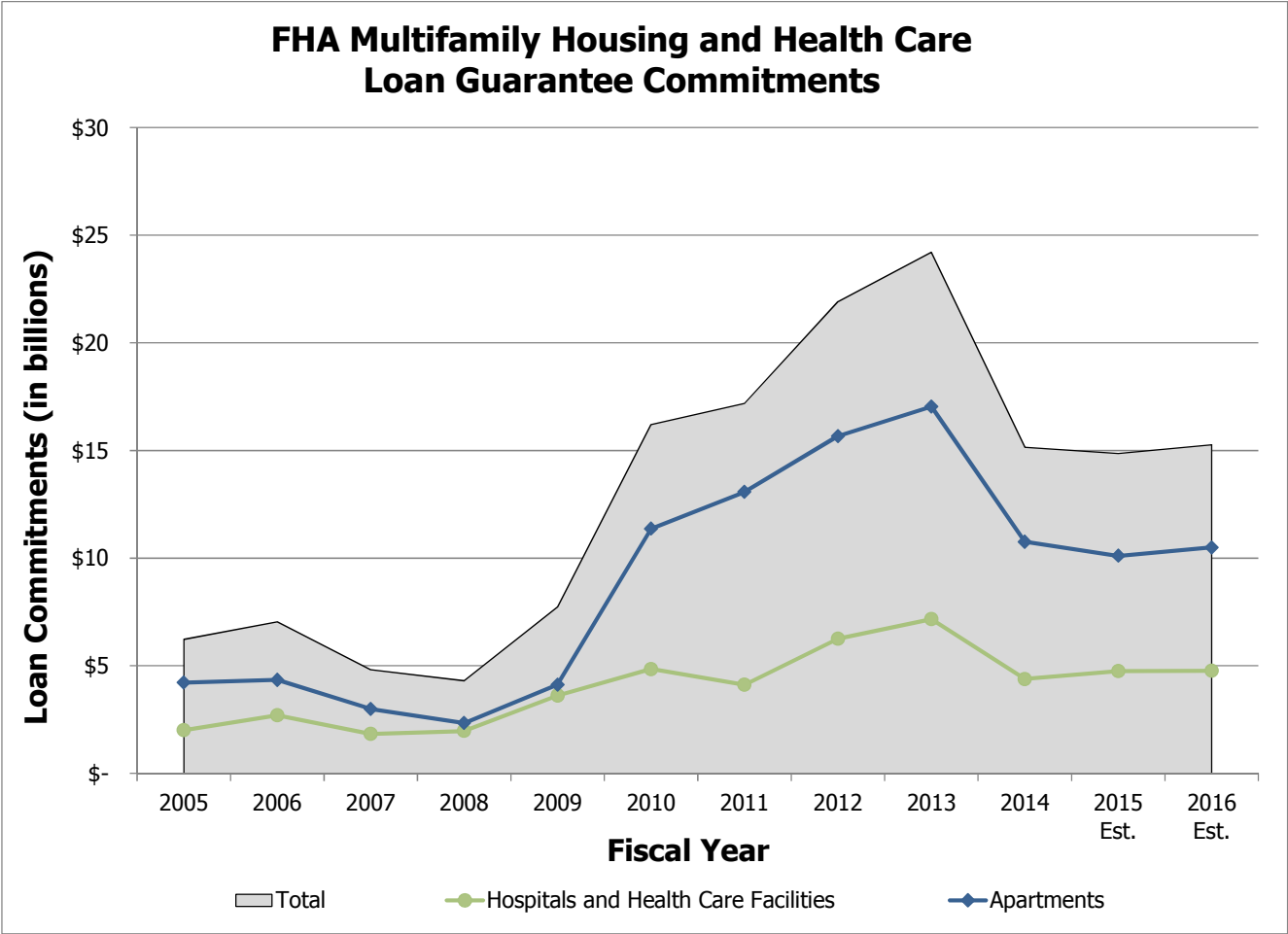
1. What is this request?

Credit programs operating under the Federal Housing Administration’s (FHA) General Insurance and Special Risk Insurance (GI/SRI) Fund fill underserved market segments and play a countercyclical role in the market by insuring critical mortgage financing for multifamily rental housing, nursing home facilities, and hospitals. GI/SRI programs also include loan guarantees for Title I manufactured housing and property improvement loans. GI/SRI houses a wide range of mortgage insurance products to address specialized financing needs, including insurance for loans to develop, rehabilitate, and refinance these properties.

The fiscal year 2016 request for GI/SRI includes four components:

Commitment authority for up to \$30 billion in new loan guarantees. New loan guarantee commitments were \$15.3 billion in fiscal year 2014 and are expected to decrease to \$15.0 billion in fiscal year 2015. In fiscal year 2015, the Department also projects \$803 million in direct loan obligations under the Federal Financing Bank (FFB) risk share program. The \$30 billion requested for fiscal year 2016, together with an estimated \$30 billion in 2015 unused commitment authority carried over to 2016, will allow up to an estimated \$60 billion in new insurance commitments. This will permit the Fund to respond to unforeseen countercyclical events while minimizing the risk of suspension of program activity as a result of having exhausted the fund’s loan guarantee limitation.

It is estimated that 2016 new loan guarantee commitments will increase modestly to \$15.4 billion. Of the total commitments projected for 2016, it is estimated that \$10.5 billion will be issued for FHA’s multifamily housing programs. Another \$4.8 billion is estimated for hospitals, nursing homes, and assisted living facility mortgages. Title I Property Improvements and Manufactured Housing commitments are expected to make up less than 1 percent of new activity in the fund. In addition, the Department projects \$600 million in direct loan obligations for fiscal year 2016 under the FFB risk share program.



Mortgage and Loan Insurance Programs-GI/SRI Account

Offsetting receipt estimates from negative credit subsidy. Fiscal year 2016 negative subsidy receipts for GISRI are estimated at \$657 million, with the subsidy rate for new business averaging -4.00 percent¹. The 2015 appropriations included a \$10 million rescission to the fund's unobligated balance. No new appropriations for positive credit subsidy are requested for fiscal year 2016.

Administrative contract funding associated with GI/SRI programs was realigned to the Mutual Mortgage Insurance (MMI) Fund beginning in fiscal year 2010 to enable more efficient management of FHA resources across mortgage insurance programs.

Commitment authority for up to \$5 million in direct loans to facilitate single family property disposition. The loan authority requested is for short-term purchase money mortgages for non-profit and governmental agencies to make HUD-acquired single family properties available for resale to purchasers with household incomes at or below 115 percent of an area's median income. This program has been infrequently utilized in recent years due to the shortage of state/local government subsidies needed to offset participants' development costs associated with administering the program. Nonetheless, this program remains a valuable tool for HUD in supporting affordable homeownership opportunities in distressed communities while responsibly managing its real estate owned (REO) inventory of properties.

	2014 Enacted	2015 Enacted	2016 Request *	Increase / (Decrease)
Loan Guarantee Limitation	\$30,000,000,000	\$30,000,000,000	\$30,000,000,000	...
(+) Unused Loan Guarantee Limitation from Prior Year	n/a	\$14,728,000,000	\$29,748,000,000	\$15,020,000,000
Subtotal, Loan Guarantee Limitation	\$30,000,000,000	\$44,728,000,000	\$59,748,000,000	\$15,020,000,000
(-) Loan Guarantee Commitments Used	(\$15,272,000,000)	(\$14,980,000,000)	(15,387,000,000)	(\$407,000,000)
Unused Loan Guarantee Limitation	\$14,728,000,000	\$29,748,000,000	\$44,361,000,000	\$14,613,000,000
Direct Loan Limitation	\$20,000,000	\$20,000,000	\$5,000,000	(\$15,000,000)

* The 2016 Unused Loan Guarantee Limitation from Prior Year and Loan Guarantee Commitments Used are estimated. Commitment authority is assumed to be used and expired on a first-in-first-out basis.

¹ The 2016 estimated negative subsidy receipts of \$657 million includes \$585 million for loan guarantee commitments and \$72 million for direct loan obligations from the FFB Risk Sharing program. The -4 percent negative subsidy rate for GI/SRI in 2016 reflects the -3.71 percent for loan guarantee commitments and -10.96 percent for direct loan obligations from the FFB Risk Sharing program.

2. What is this program?

Multifamily and healthcare loans constitute 99 percent of new insurance commitments in GI/SRI. At the end of fiscal year 2014, GI/SRI's multifamily/healthcare portfolio had an unpaid principal balance (UPB) of \$101.1 billion on 13,906 loans, an increase of \$8.0 billion over that at the end of September 2013. Historically low interest rates provided the opportunity for FHA to strengthen and preserve its existing Multifamily and Healthcare portfolio through refinancing. However, new commitment volume for fiscal year 2014 dropped to \$15 billion from \$24 billion in 2013, principally due to higher interest rates, which resulted in lower refinancing volumes.

FHA has insured mortgages on approximately 42 million single family and multifamily properties since its inception in 1934 under both MMI and GI/SRI Funds. As of the end of fiscal year 2014, the GI/SRI insurance portfolio had an unpaid principal balance of \$152.7 billion, including \$50.9 billion in single family and Home Equity Conversion Mortgage (HECM) loans issued before 2009. These active loans cover more than two million apartments, healthcare facility beds, and single family homes across the nation. FHA mortgage insurance enhances a borrower's credit and provides banks with better access to capital markets, most notably through Ginnie Mae securities. In exchange for adherence to strict underwriting and application requirements established by HUD and the payment of annual insurance premiums, HUD-certified lenders are able to file claims with FHA when a borrower defaults. Mortgage insurance premiums and specific terms for claim payments vary by program.

FHA mortgage insurance works in part by helping private lenders access liquidity otherwise not available to borrowers developing or maintaining rental housing for low- and moderate-income families. The credit enhancement provided by an FHA loan guarantee enables borrowers to obtain long-term, fully amortizing financing (up to 40 years in the case of new construction/substantial rehabilitation) which can result in substantial cost savings.

FHA mortgage insurance provides long-term amortization not found with conventional lending sources. The fact that FHA loans are fully amortizing mitigates interest rate risk for owners because they do not necessarily have to refinance to maintain affordability of their payments. The long-term amortization period and guarantee of payment in the event of claim stabilizes interest rates and can also allow monthly mortgage payments to be less than payments required under non-insured financing. These savings in turn can reduce the overall costs of developing and maintaining housing, stabilizing housing markets and benefiting low- and moderate-income residents. Similarly, FHA financing of healthcare facilities contributes to lower healthcare costs for taxpayers and consumers.

Multifamily and healthcare loans are large and complex, as seen in the program administration. Prior to receiving a mortgage guarantee for any multifamily or healthcare loan, lenders and borrowers must complete a rigorous application process in which HUD staff review borrower credit worthiness, project cash flow projections, property appraisals, architectural design, environmental impact, requested loan size, quality of the property management, and other information that establishes a loan as an acceptable credit risk to HUD. Large multifamily housing projects and all healthcare facility loans receive secondary review and approval by a

Mortgage and Loan Insurance Programs-GI/SRI Account

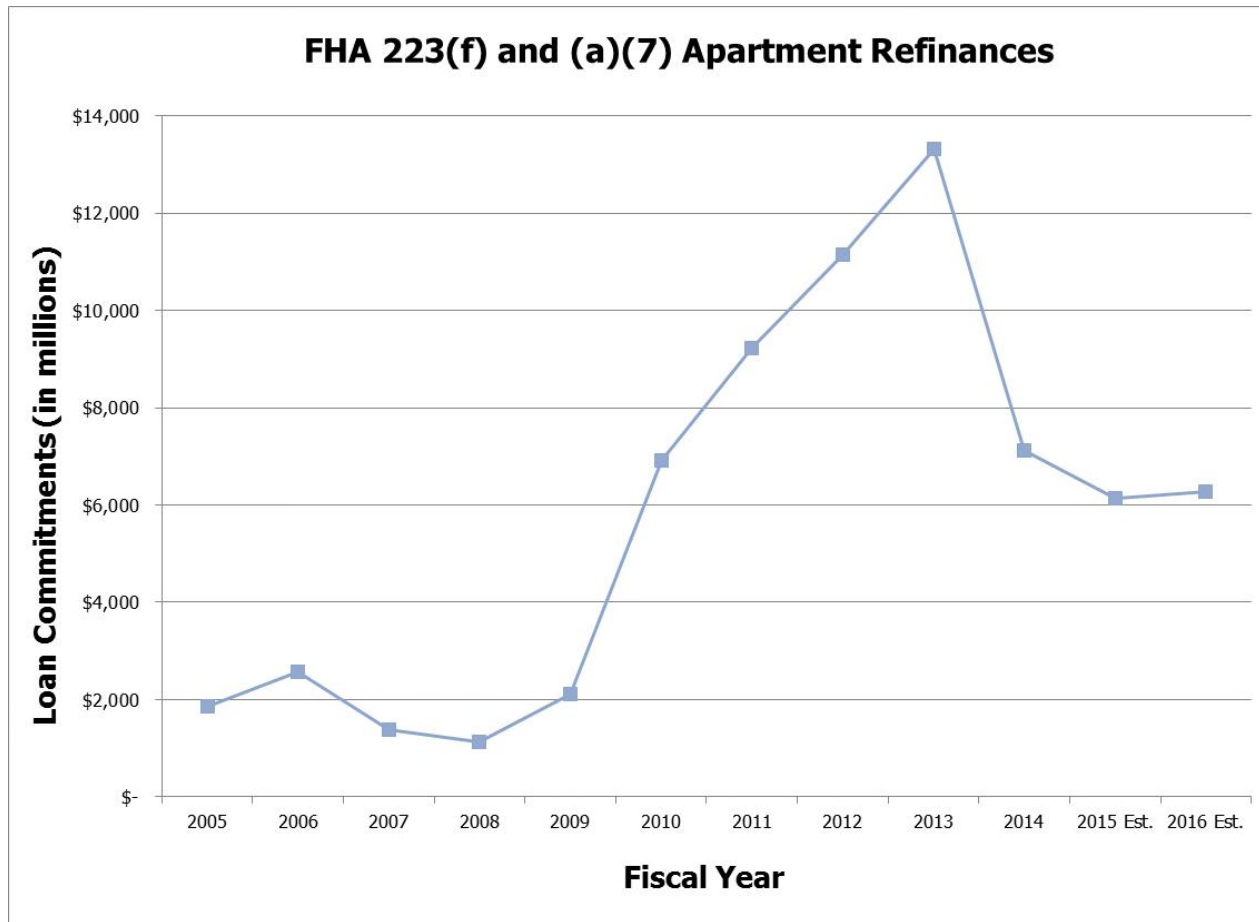
national loan committee of senior HUD officials. Once insurance has been approved, progress on any new construction or renovation is closely monitored by HUD inspectors. HUD asset managers monitor project financial statements on an ongoing basis and periodic physical inspections are conducted by HUD's Real Estate Assessment Center. Loss mitigation measures, including a partial payment of claim policy approved in 2010, are undertaken before a default and full claim on the loan occurs. When a borrower does default and a claim is filed, HUD will take possession of the mortgage note or property and seek to recover losses.

Multifamily Housing Risk Categories

Section 221(d)(4) Mortgage Insurance for Rental and Cooperative Housing. The Section 221(d)(4) program is FHA's largest new construction/substantial rehabilitation for multifamily housing. In 2014, new Section 221(d)(4) loans averaged \$12.8 million and included an average of 148 units. The program insures loans for up to 90 percent of the project replacement cost (as limited by debt service coverage and per-unit cost requirements). The program covers long-term mortgages of up to 40 years and, like all FHA new construction loan programs, provides for both construction and permanent financing.

Section 223(f) Mortgage Insurance for Refinancing or Purchase of Existing Multifamily Rental Housing. Section 223(f) is currently the highest volume program operating under GI/SRI. It allows for long-term mortgages of up to 35 years for refinance or purchase of existing multifamily rental housing. Refinances of current FHA-insured multifamily loans are also offered under Section 223(a)(7), but are grouped together with Section 223(f) for budgetary purposes.

Commitments under these programs totaled \$7.1 billion in fiscal year 2014, a decrease of 47 percent from fiscal year 2013. In the period from fiscal years 2009 – 2014, FHA issued commitments in excess of \$47 billion as indicated in the chart below. The lower volume in 2014 is due to higher interest rates and a much more robust capital environment. Since interest rates are expected to stay more or less the same or increase gradually, fiscal year 2015 volume is expected to decrease by 14 percent. Fiscal year 2016 volume is forecasted to remain flat.



Section 241(a) Mortgage Insurance for Supplemental Loans for Multifamily Housing Projects. Section 241(a) provides mortgage insurance for supplemental loans for multifamily housing projects already insured or held by HUD. Beginning in fiscal year 2013, each 241(a) loan is assigned to the risk category of the FHA-insured first mortgage. In fiscal year 2014 one Section 241(a) loan was insured. This program is intended to keep projects competitive, extend their economic life, and finance the replacement of obsolete equipment. Section 241(a) mortgages finance repairs, additions, and other improvements. These loans take second position to the primary mortgage.

Mortgage and Loan Insurance Programs-GI/SRI Account

Section 542(b) Risk Sharing with Qualified Participating Entities (QPEs). This is one of two multifamily programs under which FHA insures only a portion of the losses by sharing the risk with Fannie Mae, Freddie Mac, and other qualified Federal, State, and local public financial and housing institutions. If a loan insured under Section 542(b) defaults, the QPE will pay all costs associated with loan disposition and will seek reimbursement from HUD for 50 percent of the losses. A variation of Section 542(b), called "Green Refinance Plus," introduced in 2011, permits QPEs to offer loans to both preserve older affordable properties and install energy-saving features by allowing expansion of the QPE's Debt Service coverage and Loan-To-Value lending limits for qualified properties. With terms of 10, 15, or 30 years (all with 30-year amortization), these loans require a Mortgage Insurance Premium (MIP) higher than under the standard Section 542(b) program. This variation of Section 542(b) is also known as "Green Risk Sharing" or "Risk Sharing Plus".

The Budget continues to propose an amendment to the Section 542(b) authorizing statute that would remove affordability restrictions for small (5-49 units) properties financed under the Small Buildings Risk Sharing (SBRS) Initiative. The change is intended to reduce the burden on owners who utilize the Risk Sharing Program to refinance or rehabilitate their properties, the small multifamily properties that are an important provider of affordable, but unsubsidized, housing for low- and moderate-income families. According to the 2010 American Community Survey, nearly one-third of all renters live in 5- to 49-unit buildings. The 2001 Residential Finance Survey also demonstrates that these small multifamily properties have lower median rents than larger properties: \$400 per month for 5- to 49-unit properties, as compared to the \$549 monthly rent for properties with 50 or more units. While 62 percent of unsubsidized 5- to 49-unit properties charge rent below \$500 per month, just 38.5 percent of larger unsubsidized properties charge rent below \$500 per month. At a time when federal budgets are shrinking and the need for affordable housing is growing, the amendments will allow us to preserve this vital asset without significant cost to the federal government, by drawing in state, local and community resources to these rental properties.

Section 542(c) Risk Sharing with Housing Finance Agencies (HFAs). Section 542(c) provides mortgage insurance of multifamily housing projects whose loans are underwritten, processed, serviced, and disposed of by state and local HFAs. FHA insurance enhances HFA bonds to investment grade and provides capital for affordable housing construction. HFAs may elect to share from 10 to 90 percent of the loss on a loan with HUD. Section 542(c) insured projects often include low-income housing tax-credits, in which case they are reported under GI/SRI's risk category for Tax Credit Projects.

Section 542 (b) and (c) FFB Financed Direct Loan and HFA Risk Share. The Federal Financing Bank (FFB) is a unit within the Treasury Department that focuses on reducing the cost of federally-assisted borrowing. Announced in June 2014, this initiative is an inter-agency partnership between HUD, FFB and Housing Finance Agencies to develop a Ginnie Mae-like financing mechanism for risk share partners. Specifically, the Federal Financing Bank (FFB) provides funding for multifamily mortgage loans insured by FHA through its Risk Sharing programs. FFB does not securitize the mortgages; rather, FFB purchases certificates backed by the FHA-insured mortgages. The proposed program substitutes FFB as the funding source until use of Ginnie Mae Securitization is allowed

Mortgage and Loan Insurance Programs-GI/SRI Account

for the Section 542 (b) and (c) programs. FFB funding rates are designed to be comparable to Ginnie Mae rates, since the FFB charges interest for a transaction based on the comparable Treasury rate plus a small liquidity premium.

Other Rental Programs. This risk category includes several relatively low-volume programs that have been grouped together for budgetary purposes, including: Section 220 loans in urban areas, Section 231 loans for elderly housing, and Section 207 loans for mobile home park development. Section 220 is a new construction program, distinct from 221(d)(4) in that it insures loans for multifamily housing projects in urban renewal areas, code enforcement areas, and other areas where local governments have undertaken designated revitalization activities. The program offers special underwriting allowances for greater mixed-use development. Section 231 is also a new construction/substantial rehabilitation program, but for projects specifically designed for senior citizens. For Section 231 projects with 90 percent or greater rental assistance, the maximum loan amount is 90 percent of the estimated replacement cost.

Tax Credit Projects. Projects assisted with Low-Income Housing Tax Credits (LIHTC) may be insured under a number of FHA multifamily programs, but are grouped together in a single budget risk category. These loans have a lower risk of default than similar projects without tax credits and require borrowers to pay lower FHA mortgage insurance premiums. Use of Section 221(d)(4) with LIHTC will likely be consistent with original estimates for 2014 given recent increased interest in FHA lending by state HFA's and other mission driven lenders for new construction and substantial rehabilitation transactions. Use of Section 223(f) with LIHTC has increased dramatically in 2014 and 2015 as a result of the Tax Credit Pilot introduced in spring 2012.

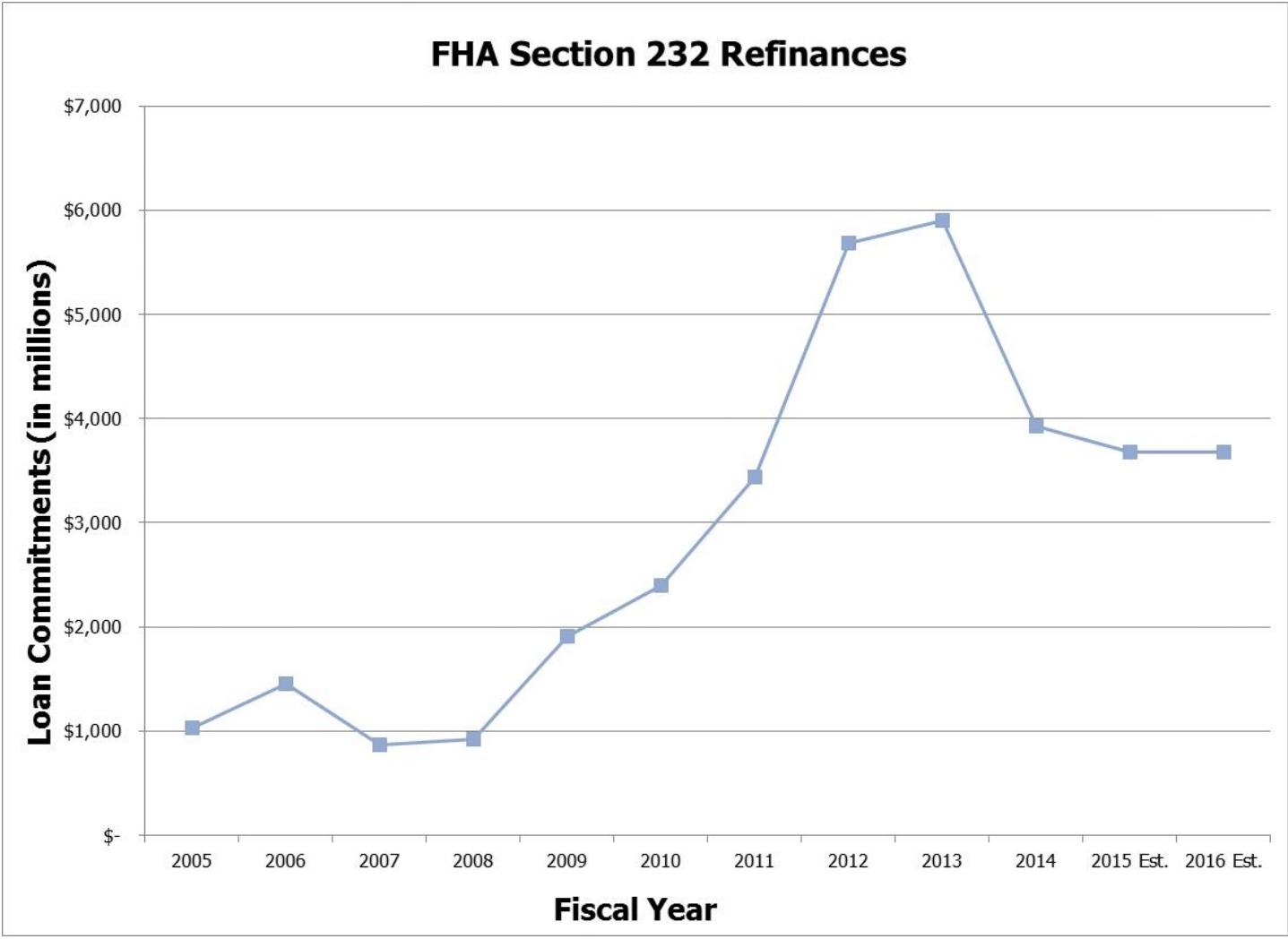
Healthcare Risk Categories

Section 232 New Construction/Substantial Rehabilitation of Skilled Nursing, Assisted Living, and Board and Care Facilities. Section 232 programs are split into two budget risk categories, the first of which includes new construction and substantial renovation projects. The program enables access to capital that may not otherwise be available for many quality providers in underserved areas, thereby providing access to needed healthcare and residences for seniors. These loans are offered for terms of up to 40 years, and provide both construction and permanent financing. This risk category also includes Section 241(a) supplemental loans made to projects with a primary FHA Section 232 mortgage. For fiscal year 2014, new loan commitments for this program were \$414 million, and are estimated to be approximately \$385 million for both fiscal years 2015 and 2016.

Section 232/223(f) Refinancing and Purchase of Existing Skilled Nursing, Assisted Living, and Board and Care Facilities. The Section 232/223(f) refinancing program, the second of the two budget risk categories of the section 232 program, has grown to be one of the highest volume insurance programs in GI/SRI, due in great part to mortgagors of existing facilities taking advantage of refinancing at low interest rates. This program offers loan terms of up to 35 years. For a refinance, maximum mortgage amounts are up to 85 percent of appraised value (90 percent if the borrower is a non-profit organization). For acquisitions, mortgages are insured up to 85 percent of the acquisition price plus transaction costs (90 percent of acquisition price if the borrower is a non-profit organization). Equity cash-out transactions are prohibited under this program. Section 223(a)(7) refinances of existing Section 232

Mortgage and Loan Insurance Programs-GI/SRI Account

loans are also reported under this risk category. New loan commitments were \$3.9 billion for fiscal year 2014 and are projected to be nearly \$3.7 billion for both fiscal years 2015 and 2016.



Mortgage and Loan Insurance Programs-GI/SRI Account

Section 242 Hospitals. The Section 242 program provides mortgage insurance for loans made to acute care hospitals. An FHA guarantee allows hospitals to lock in low interest rates and reduce borrowing costs for major renovation, expansion, replacement, and refinancing projects that help improve healthcare access and quality. Loans are up to 25 years in length, plus a construction period. The risk category also includes the following types of loans when made to hospitals: Section 241(a) supplemental loans; Section 223(a)(7) loans for refinancing current FHA-insured projects; and Section 223(e) loans for hospitals in older, economically declining urban areas. On February 5, 2013, HUD published a final rule that enables HUD to offer Section 242/223(f) refinance loans. Under the standard Section 242 program, refinances are offered only for existing FHA loans, with all other loans required to be at least 20 percent new construction. New loan commitments for all Hospital programs were \$43 million in fiscal year 2014 and are projected to reach nearly \$700 million in fiscal years 2015 and 2016.

Section 223(d) Mortgage Insurance for 2-year Operating Loss Loans. Section 223(d) insures short term loans that cover operating losses during the first 2 years after a project's completion (or any other 2-year period within the first 10 years after completion) for projects with a HUD-insured first mortgage. Since 2012, HUD has offered this type of mortgage insurance only to healthcare facilities with a primary mortgage under Section 232. Mortgage insurance on this type of loan has previously been offered (though infrequently utilized) for multifamily housing, but it is no longer viewed as a cost-effective means for preventing future losses on the associated primary FHA mortgages. The program remains a valuable option for Section 232 projects, which are more likely to benefit from the early infusion of working capital and thus avoid default on the primary mortgage. Beginning in fiscal year 2013, each 223(d) loan is assigned to the risk category of the associated primary FHA mortgage.

Single Family Risk Categories

Title 1 Property Improvement. The Title I Property Improvement program insures loans for repairs and other improvements to residential and non-residential structures, as well as new construction of non-residential buildings. Property Improvement disbursements were \$102 million in fiscal year 2014 and are projected to be \$101 million in fiscal years 2015 and 2016. In 2011, FHA launched a "PowerSaver" pilot program that has generated new loan volume for this risk category. Operating under Title 1 authority and regulatory framework, PowerSaver provides single-family homeowners loans of up to \$25,000 for proven energy-saving improvements. Program lenders received incentive grants from the HUD Energy Innovation Fund to help lower the cost of loans to consumers. PowerSaver was designed as a two-year pilot, and later extended through May 4, 2015.

Title 1, Manufactured Housing. Under Title I, HUD provides mortgage insurance for individuals to purchase manufactured homes. In fiscal year 2014, \$24 million in manufactured housing loans were endorsed, with \$21 million projected for fiscal years 2015 and 2016.

3. Why is this program necessary and what will we get for the funds?

FHA's multifamily and healthcare programs are a critical component of the Department's efforts to meet the Nation's need for decent, safe and affordable housing. These programs provide the necessary liquidity so that communities can continue to provide

Mortgage and Loan Insurance Programs-GI/SRI Account

quality affordable housing and assisted living/nursing home opportunities. In fiscal year 2016, FHA is projected to issue loan insurance commitments providing financing for over 1,200 apartment projects and for 450 healthcare facilities. The fiscal 2016 request supports mortgage insurance programs that are essential in achieving the Department's mission of strong, sustainable, inclusive communities and quality affordable homes for all. More specifically:

- FHA mortgage insurance encourages private lenders to make loans for important projects that might otherwise not be possible. New workforce housing in high demand markets, innovative "green" technology renovations, nursing homes serving aging senior citizens, and critical access hospitals are among the types of projects that FHA makes possible. In fiscal year 2014, HUD endorsed a total of 1,566 multifamily and healthcare loans in GI/SRI in 50 states, the District of Columbia, Virgin Islands and Puerto Rico, covering more than 225,000 units of housing and healthcare facility beds.
- In addition to providing better access to credit for new developments, FHA supports refinance lending that preserves financially healthy housing and healthcare projects by helping them to reduce high current debt obligations. FHA's major refinancing programs for housing and nursing home facilities offer long-term amortization periods and are a critical option for many conventionally financed projects facing large balloon payments. FHA refinancing may also enable properties to undertake needed renovation and rehabilitation. New loan insurance commitments in 2014 included 1,218 refinances of existing properties with more than 135,000 apartment homes and more than 50,600 nursing home/assisted living beds.
- FHA mortgage insurance has a strong secondary effect of creating and preserving jobs. FHA projects can be significant contributors to the economic health of a community. The Office of Healthcare Programs (OHP) has developed a tool to measure the economic impact of its insurance programs. Using the widely respected IMPLAN economic model, OHP calculated the economic benefits for the residential care facilities (with construction projects) that received mortgage insurance commitments in fiscal year 2014. In fiscal year 2014, OHP's Section 232 Program issued 32 firm commitments involving construction: 14 new construction projects, 13 section 241(a) projects, 2 blended rate projects, and 3 substantial rehabilitation projects. These projects will create up to 6,500 full-time equivalent construction jobs during their construction periods with a total construction economic impact of \$900 million. Once the projects are fully constructed, the residential healthcare facilities will create over 3,500 full time equivalent jobs and provide their communities with an annual economic impact of over \$450 million.

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The following tables indicate projected FFB risk share direct loan levels and loan guarantee commitment volumes in fiscal years 2014, 2015 and 2016 and their respective credit subsidy rates and negative subsidy in fiscal year 2016. Credit subsidy rates represent the projected net present value cost or savings to the government of operating a loan guarantee program, and take into account projected claims, pre-payments, premium revenue, and recoveries on defaults for a cohort of loans over their lifetime.

For more information on credit subsidy calculation please see the Notes section of this justification.

GI/SRI PROGRAMS (IN \$MILLIONS)	Direct Loan Level Actuals <u>FY2014</u>	Direct Loan Level Estimates <u>FY2015</u>	Direct Loan Level Estimates <u>FY2016</u>	Subsidy Rate <u>FY2016</u>	Negative Subsidy Budget Authority <u>FY2016</u>
Multifamily					
FFB-Financed Direct Loan and HFA Risk Share	\$0	\$803	\$600	-10.96%	(\$66)
Offsetting Receipts Paid to Treasury	\$0	\$65	\$72		

Mortgage and Loan Insurance Programs-GI/SRI Account

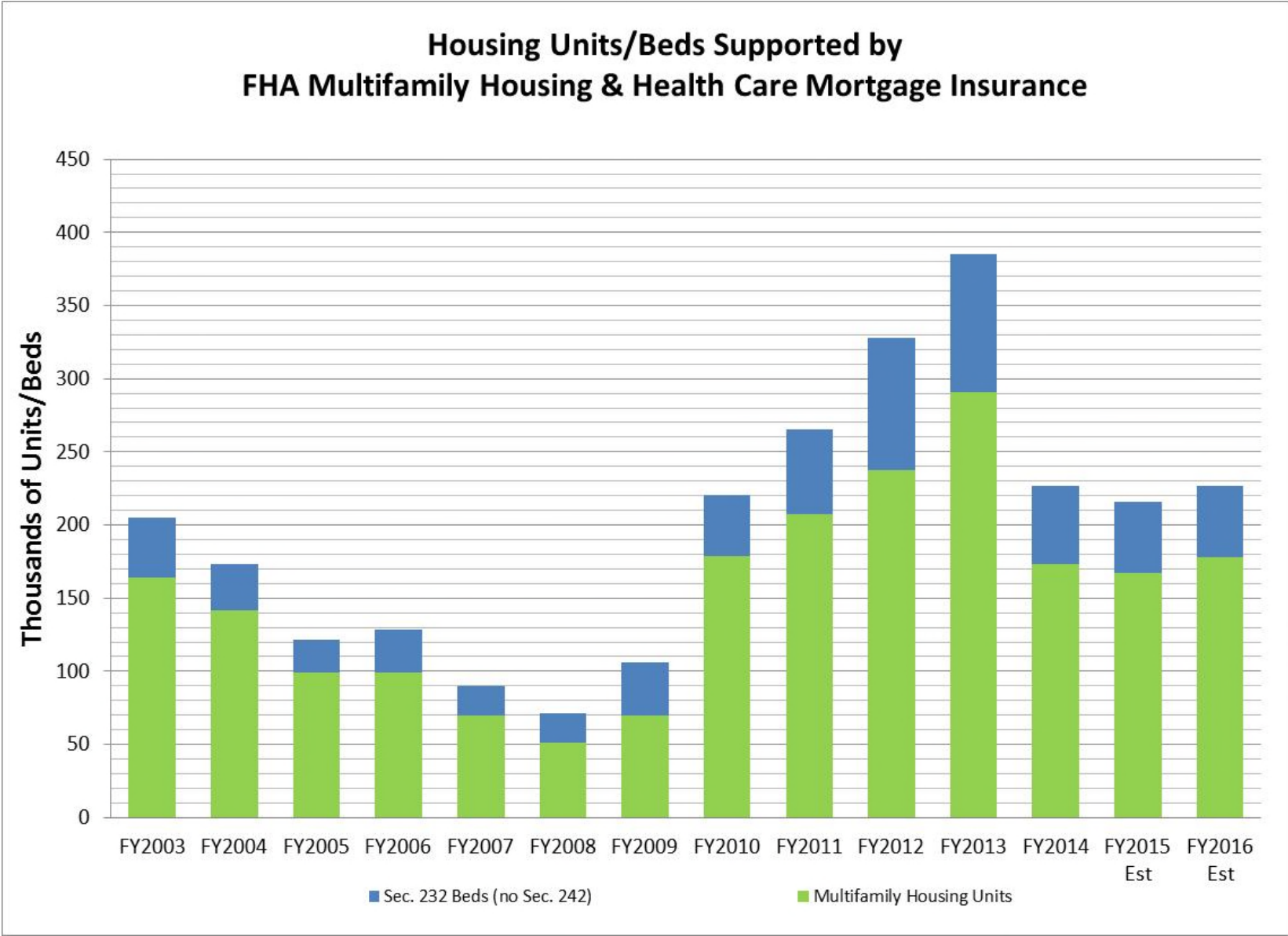
GI/SRI PROGRAMS (IN \$MILLIONS)	Commitment Actuals	Commitment Estimates	Commitment Estimates	Subsidy Rate	Negative Subsidy Budget Authority
	<u>FY2014</u> ¹	<u>FY2015</u>	<u>FY2016</u>	<u>FY2016</u>	<u>FY2016</u>
Multifamily					
221(d)(4) Apartments New Constr/Sub Rehab	\$1,705	\$1,393	\$1,408	-2.74%	(\$39)
Tax Credit Projects	\$1,761	\$2,300	\$2,500	-1.69%	(\$42)
223(f)/223(a)(7) Apartments Refinance/Purchase	\$7,114	\$6,142	\$6,277	-4.67%	(\$293)
HFA Risksharing	\$140	\$115	\$138	-1.28%	(\$2)
GSE Risksharing	\$25	\$88	\$103	-1.65%	(\$2)
Other Rental (Sections 220,231,207)	\$15	\$67	\$74	-1.17%	(\$1)
Multifamily Housing Subtotal	\$10,760	\$10,105	\$10,500		(\$379)
Section 242 - Hospitals (includes Refinances & Supplemental Loans)	\$43	\$688	\$700	-3.22%	(\$23)
Section 232 - Nursing Homes/Assisted Living					
Full Insurance for Health Care Facilities	\$414	\$385	\$385	-3.43%	(\$13)
Health Care Facility Refinance	\$3,929	\$3,680	\$3,680	-4.23%	(\$156)
Section 232 Subtotal	\$4,343	\$4,065	\$4,065		(\$169)
Healthcare Housing Subtotal	\$4,386	\$4,753	\$4,765		(\$192)
Title I					
Title I Property Improvements	\$102	\$101	\$101	-0.84%	(\$1)
Title I Manufactured Housing	\$24	\$21	\$21	-4.20%	(\$1)
Title I Subtotal	\$126	\$122	\$122		(\$2)
GI/SRI TOTAL	\$15,272	\$14,980	\$15,387	-3.71%	(\$573)
Offsetting Receipts Paid to Treasury ²	\$608	\$643	\$585		

1. Total is net of commitment authority restored due to owner withdrawal prior to closing or for non-compliance with terms.

2. Negative subsidy is obligated when the commitment for insurance is issued and disbursed subsequently at the time of initial endorsement.

4. How do we know this program works?

The greatest testament to FHA's effectiveness is the tangible result of its programs. Quality housing and healthcare facilities are made possible and/or more affordable throughout the country due to an FHA mortgage guarantee. For example, over the last 10 years, FHA GI/SRI insurance has supported over 1.3 million multifamily housing units, 116,000 assisted living and board and care housing units, 367,000 skilled nursing care beds, and 19,000 hospital beds. FHA-insured projects can have a significant impact on the economic health of the community, as described in the previous section.



Mortgage and Loan Insurance Programs-GI/SRI Account

With each mortgage it insures, FHA carefully considers the benefits to the community along with financial risks to the government. Cognizant of the increased risks associated with FHA's expanding role in the housing market, the Department has launched several new initiatives aimed at appropriately managing the risk involved with multifamily loans. In fiscal year 2010, FHA made a number of updates to underwriting requirements for multifamily housing loans. These updated requirements are part of a broader strategy that features a national loan committee process for all large projects, new initiatives (under development) to improve lender oversight, and a revised partial payment of claim policy that will generate savings by reducing the number of full claims. FHA also adopted a more balanced approach to loan-to-value and debt service coverage requirements and increased scrutiny of borrowers' other real estate obligations that could jeopardize their financial positions and make it more difficult for them to assist projects with financial or operational challenges. FHA is taking steps such as these to ensure its policies and practices do not contribute to any unanticipated losses.

In addition to the multifamily risk management processes, FHA has also taken steps to improve program administration of the healthcare insurance programs through business process improvements. For the Section 232 program, a LEAN Process has been adopted for both new construction and refinance applications. LEAN Processing employs standardized work product and processes to obtain a consistent, timely result. The following are some of the specific changes implemented with LEAN Processing: standardized checklists, statements of work for third party work, certifications, and templates for the lenders to use in their assembly of the application package; development of standardized punch lists for HUD staff to use in their underwriting of submitted applications; initiation of HUD legal review immediately when the Firm Application is submitted in order to cut down the time required between Firm Commitment issuance and closing; and removal of portions of the application process/requirements that were duplicative or not necessary.

For multifamily housing insurance programs, FHA launched the "Multifamily for Tomorrow" initiative that focuses on optimizing processes, strengthening risk management, developing specialized skills of the staff and strengthening the way the organization manages this workload. The Office of Multifamily Housing is standardizing processes to achieve consistent and timely results by creating a standardized loan underwriting review template, adopting an early warning

Insurance in Force	\$152.7 Billion
New Commitments	\$15.3 Billion
Average Multifamily Housing Loan	\$10.1 Million
Average Section 232 Loan	\$8.8 Million
Average Hospital Loan	\$31.3 Million
Negative Subsidy Offsetting Receipts	\$608 Million
Premiums Collected	\$843 Million
Claims Paid – Single-Family/HECM	\$2.4 Billion
Claims Paid - Multifamily/Healthcare	\$248 Million
Recoveries on Claims	\$656 Million

Mortgage and Loan Insurance Programs-GI/SRI Account

system, creating application staging areas, and standardizing work products. One of the signature elements of Multifamily for Tomorrow is the new Single Underwriter model, which assigns a single champion to a transaction. The champion coordinates with specialists as needed during the underwriting process. In addition a new workload management system, ASAP, is being rolled out to better track deal flow. Specifically, within a span of only 7 months, FHA's efficiency improvement efforts have resulted in the decrease in the number of applications in processing for over 90 days, from 191 to 50.

5. Proposals in the Budget

- Eligibility for FHA-insured Properties: Clarifies that low-and-moderate income persons under 62 years of age are eligible for occupancy of dwelling units in a project financed with a mortgage insured under 221(d)(4), similar to those with a mortgage insured under 221(d)(3). (Section 237)
- Loan Assignment Authority: Eliminates Section 221(g)(4) of the National Housing Act regarding loan assignment authority. The provision is no longer necessary because there are no longer any outstanding loans remaining in the portfolio that would qualify under this provision. (Section 238)
- Remove "Technical Suitability of Products Program" Requirement: Remove from mandatory use the "Technical Suitability of Products Program" for programs covered under FHA's mortgage insurance platform. This program has fallen into disuse as the industry and HUD are increasingly relying on industry standards. (Section 246)
- FHA/Ginnie Mae Risk Sharing Securitization: HUD is expanding its pool of risk sharing lenders to include lenders that have demonstrated experience in affordable housing lending, specifically in order to increase the availability of capital to small multifamily properties of 5-49 units. The language would authorize Ginnie Mae to securitize these small loans made under Section 542(b). (Section 224)
- Multifamily Risk Share Program: Amendment of Affordability Restrictions for Small Buildings: The language would remove some of the affordability restrictions currently required under Section 542(b), for loans originated under the small buildings initiative, in order to reduce the ongoing burden on owners. Specifically, the language will remove the requirement for owners to perform annual income recertifications for residents. These small properties are underserved by the conventional market, and are traditionally underserved by FHA as well. The provision focuses on the particular needs of very small (20 units and under), unsubsidized properties. These small properties comprise a significant share of rental housing in certain urban areas. Small multifamily properties are an important means for the Department to meet its affordable housing and community development goals. These properties are more likely to be owned by small entities

Mortgage and Loan Insurance Programs-GI/SRI Account

or individuals, tend to be concentrated in lower income neighborhoods, and often offer rents affordable to households below median income. (Section 221)

- Critical Access Hospitals: Eliminates the sunset date and makes permanent the exemption for Critical Access Hospitals from the requirement that fifty percent of patient days must be for acute care services. That requirement is not appropriate for small rural hospitals, which provide many sub-acute services to their communities. Since 2003, the exemption has allowed 10 such hospitals to qualify for mortgage insurance to modernize or replace their facilities. (Section 245)

6. Notes to Justification

GI/SRI Single Family Portfolio

In addition to new insurance commitments for the multifamily, healthcare and Title 1 programs, the GI/SRI fund also houses activity on mortgage insurance and HUD-held notes for a number of large single family programs. Prior to fiscal year 2009, the GI/SRI Fund housed new insurance for a number of significant single family insurance programs, such as the Home Equity Conversion Mortgage (HECM) reverse mortgage guarantees and condominium unit financing. With the enactment of the Housing and Economic Recovery Act of 2008 (HERA), financial responsibility for almost all single family programs was transferred to the Mutual Mortgage Insurance (MMI) Fund. However, obligations made prior to 2009 (and the associated cash flows) remain in GI/SRI.

Credit Subsidy Calculations and the Annual Re-estimate

Credit subsidy rates represent the projected net cost or savings to the government of operating a loan guarantee program, and take into account the present value of projected claims, pre-payments, premium revenue, and recoveries on defaults for a cohort of loans over their lifetime. In accordance with the Credit Reform Act of 1990, administrative costs (excluding property disposition) are not included in credit subsidy calculations. FHA credit subsidy rates reflect historic performance data for similar loans made over the past 40 years, with adjustments made for significant policy shifts as well as changing economic and market conditions. The Department devotes significant efforts to ensure accurate credit subsidy estimates. Each year the extensive statistical base from which projections of future loan performance are calculated is updated with an additional year of actual data. The Department and OMB continue to examine the data, assumptions, and calculations that are used to estimate loan program cash flows and subsidy rates in order to improve the accuracy and reliability of cost projections.

Each year, FHA completes a required re-estimate of liabilities and subsidy costs associated with the existing insurance portfolio. For more information on subsidy rates and re-estimates, please see the Federal Credit Supplement to the President's Budget, available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/cr_supp.pdf

**HOUSING
GENERAL AND SPECIAL RISK INSURANCE FUND
SUMMARY OF RESOURCES BY PROGRAM
(Dollars in Thousands)**

<u>Budget Activity</u>	<u>2014 Budget Authority</u>	<u>2013 Carryover Into 2014</u>	<u>2014 Total Resources</u>	<u>2014 obligations</u>	<u>2015 Budget Authority</u>	<u>2014 Carryover Into 2015</u>	<u>2015 Total Resources</u>	<u>2016 Request</u>
Positive Subsidy								
Appropriation	\$16,403	\$16,403	...	-\$10,000	\$16,408	\$6,408	...
Total	16,403	16,403	...	-10,000	16,408	6,408	...