U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FHA Fiscal Year 2009 Actuarial Review Briefing

November 12, 2009

Your Door to FHA HOMEOWNERSHIP

FEDERAL HOUSING ADMINISTRATION

Today's Briefing

➢Summary

- Role of FHA in the housing and economic recovery
- Findings of FY 2009 FHA Actuarial Review
- Facts about FHA's financial status
- Real risks to FHA and FHA's reforms
- Questions and Answers

Key Points

1. FHA is temporarily playing an increased role to support the return of private capital to the housing market
2. The actuarial review expects significant losses on loans made before 2009, but concludes that under most economic scenarios considered FHA's reserves will remain positive
3. FHA loans perform substantially better than subprime loans and new borrower quality has improved significantly
4. FHA has taken action to address risks to its portfolio and is actively considering additional measures

The Actuarial Review Finds That the FHA Can Cover Projected Claims on Outstanding Loans

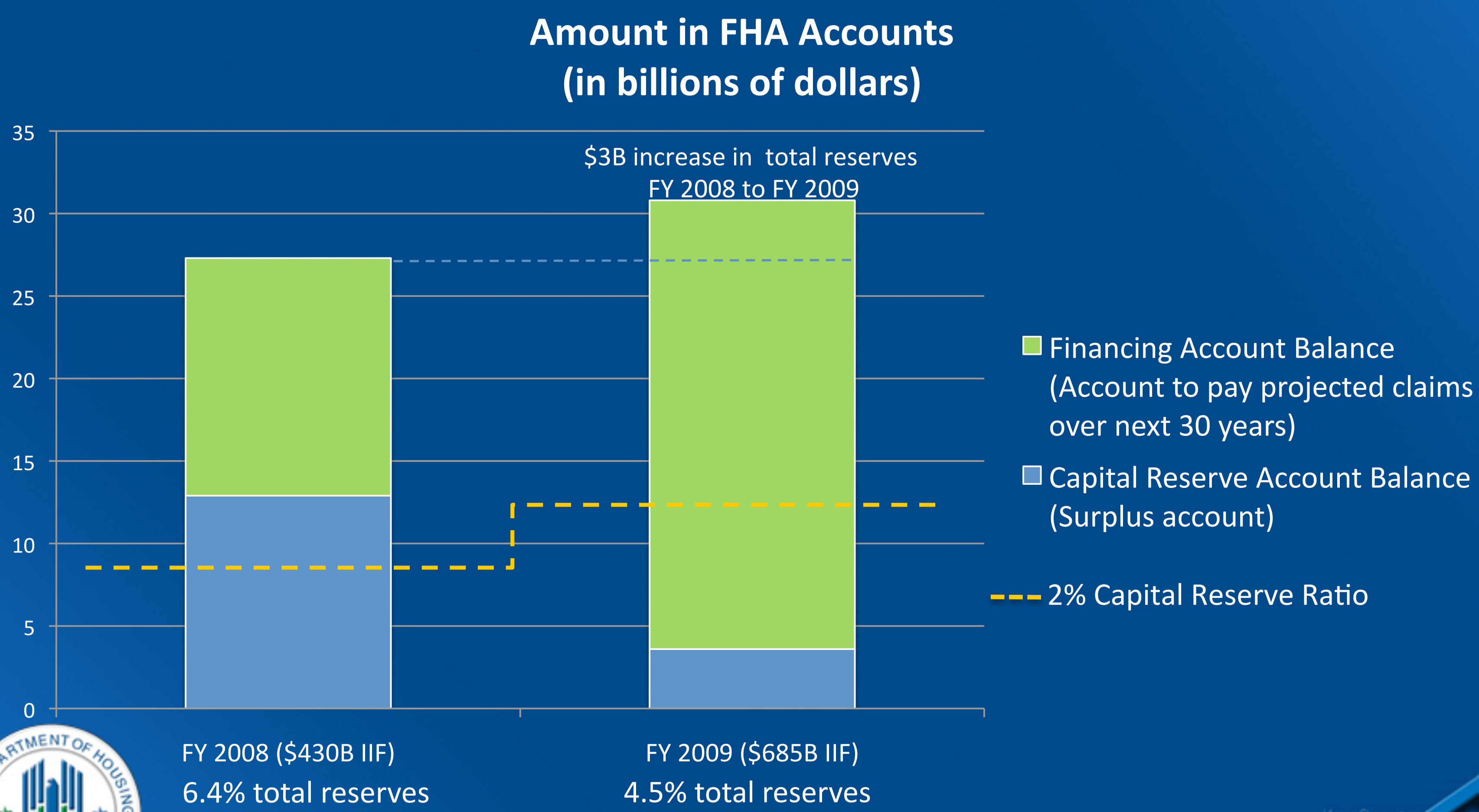
The actuarial review states:

- **FHA has $31 billion in total reserves**
- **With FHA's recent growth, this represents a 4.5% total reserve ratio on its total insurance-in-force**
- **The capital reserve ratio, a measure of excess reserves beyond forecasted net claim costs on outstanding loans, is 0.53%**
- **Under the base case, FHA can cover projected claims on outstanding loans, with a $3.6 billion cushion**

The Capital Reserve Account Holds Excess Reserves Beyond Forecasted Claims

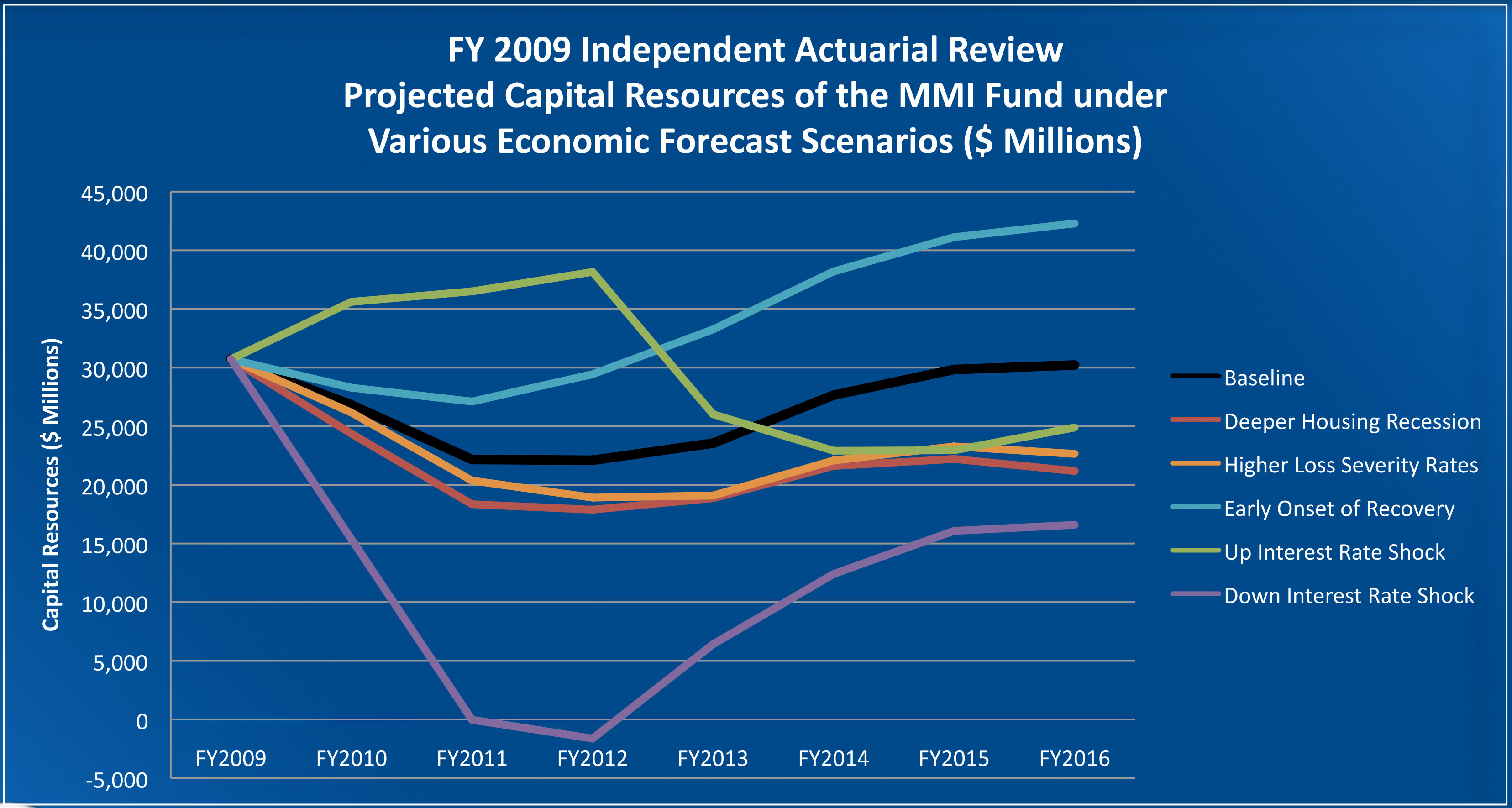
- FHA has two reserve accounts
  - Financing Account holds reserves to pay forecasted claims over the next 30 years
  - Capital Reserve Account holds excess reserves beyond the financing account
- The Capital Reserve Account was created in 1990, after the economic decline of the 1980s, to accumulate excess reserves for use in times of economic stress. The 2% excess capital ratio was achieved in 1995
- During the current historic decline in the housing sector, the capital reserve account has served its purpose by providing additional funds to pay claims above those that were originally forecasted
- This year's actuarial review incorporates updated economic conditions into forecasts of expected losses on outstanding loans, which has led to shifting additional funds from the capital reserve to the financing account
- FHA is making program and management changes designed to bring capital reserves promptly back to the 2% level

While The Capital Reserve Account and Total Reserve Percentage Have Declined, The Overall Capital In Reserve Has Increased To $31 Billion



Source: FY 2009 independent actuarial study of forward and reverse mortgages

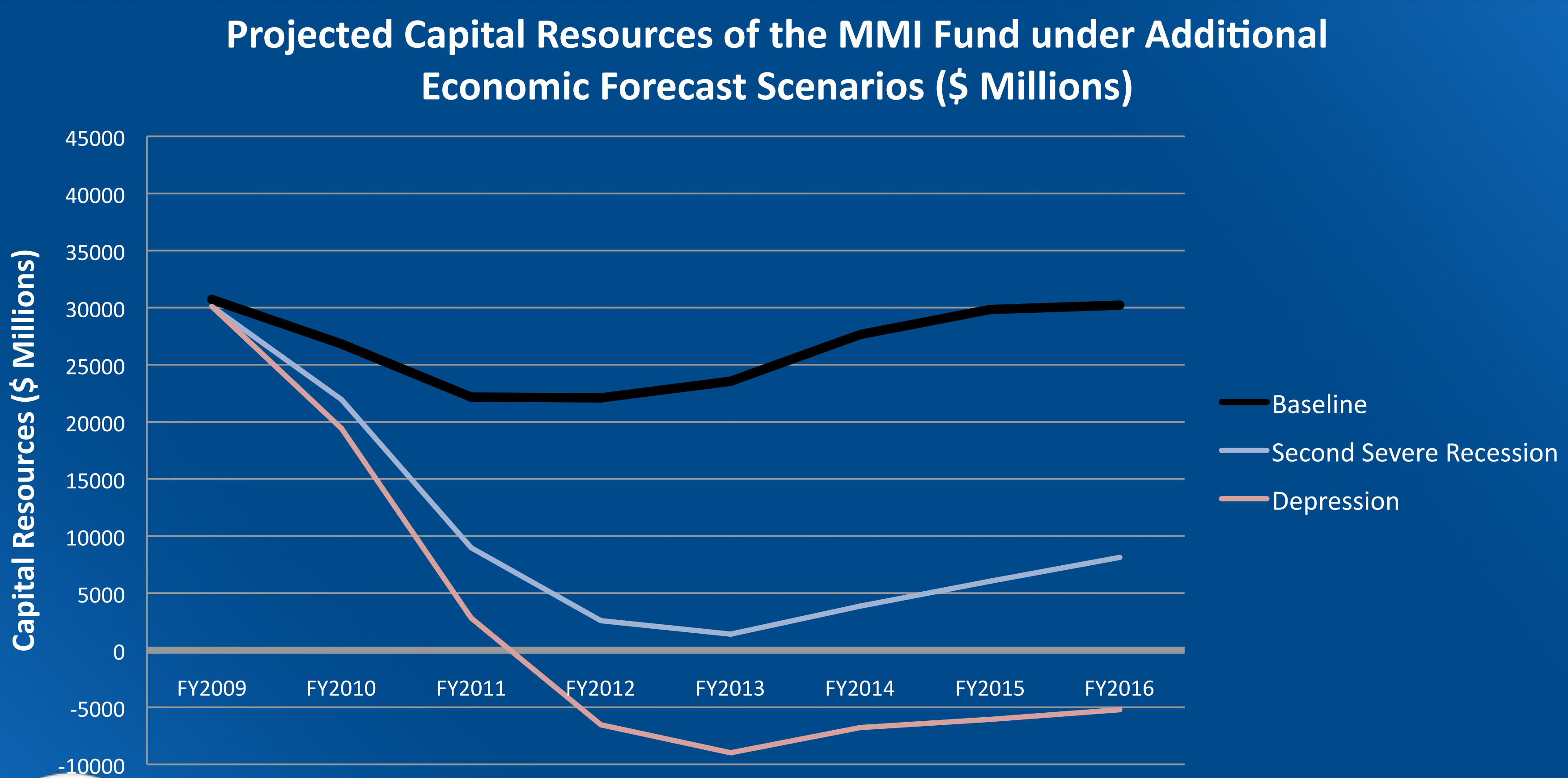
The Actuarial Review Reports That FHA Will Maintain Positive Reserves Under A Range of Economic Scenarios



The Actuarial Review Reports That FHA Will Maintain Positive Reserves Under A Range of Economic Scenarios

Base Case	Peak-to-trough house price decline of 14% in the FHFA index. Includes an 8.6% decline from mid-2009 to mid-2010. This represents the forecast by IHS Global Insight as of August 2009. The total peak-to-trough decline is equivalent to a 21% decline in the Case-Shiller 10-city index.
Deeper Recession	Peak-to-trough house price decline of 19% in the FHFA index. Includes a 13% decline from mid-2009 to mid-2010. This represents the more pessimistic forecasts made by IHS Global Insight from late 2008 through mid 2009. The total peak-to-trough decline is equivalent to a 27% decline in the Case-Shiller 10-city index.
Up Rate Shock	Base-case house price decline plus mortgage interest rates rise by 3 percentage points and stay there for three years. This simulates what could happen if capital were to suddenly flow out of mortgage markets.
Down Rate Shock	Base-case house price decline plus mortgage rates drop by 3 percentage points and stay there for three years. This simulates what could happen if the economy became stagnant with excess capacity and there were, as a result, increased capital flows into the mortgage market.
Earlier Recovery	Presumes that the national housing market is now finding its trough, and that there will be no further home price declines in 2010.
Higher loss severity	In addition to base-case home price declines, FHA losses on REO dispositions are 5 percentage points higher than predicted, and for the entire 30-year forecast period. This simulates a scenario whereby either the expenses of foreclosure and property management are permanently increased, or else REO property values stay low for a long period of time due to oversupply.

FHA Evaluated Additional Scenarios Beyond Those in the Actuarial Review



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Second Severe Recession	Peak-to-trough house price decline of 25% in the FHFA index. The total peak-to-trough decline is equivalent to approx. 34% in the Case-Shiller 10-city index. Unemployment of 11%. Prepayment rates 10% slower.
Depression	Peak-to-trough house price decline of 35% in the FHFA index. The total peak-to-trough decline is equivalent to approx. 50% decline in the Case-Shiller 10-city index. Unemployment of 12.5%. Prepayment rates 25% slower.

Implications of This Review

- Under the base case, and most other economic scenarios examined in the actuarial review, the capital account has enough reserves to cover projected claims on outstanding loans

- FHA also evaluated more extreme economic scenarios, under which FHA's capital reserves would be further eroded

- FHA operates under the full faith and credit of the United States government -- under all scenarios
  - The FHA has standing authority to cover all claims

Implications of This Review

- The FHA has taken steps to address these risks and continues to make reforms that will improve the performance of the Fund:
  - Increasing risk management capabilities including hiring the organization's first Chief Risk Officer, along with other policy changes
  - Tightened rules for appraisals and lender approvals and strengthening enforcement of problem lenders
  - Stopped problem loans including those made with seller-financed downpayment assistance
- FHA continues to monitor and test the strength of its portfolio for future risks and developments in the economy and will respond accordingly

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FHA Is Playing A Critical Role In The Housing Market

- FHA's historic countercyclical role is to provide temporary support to housing markets and to step back upon the return of private capital
- This is a role that Congress has endorsed consistently
- FHA has provided temporary support to housing markets on multiple occasions throughout its 75 year history and has contributed a net positive return to taxpayers
  - Great Depression
  - Oil Patch Crisis
  - Today

FHA Is Playing A Critical Role In The Housing Market

- After a record decline in private financing and mortgage market volume, FHA is facilitating the recovery of the housing sector
  – FHA insured 995,590 purchase loans and 836,528 refinances in FY 2009, almost 30% of total purchases and 20% of total refinances in the housing market
  – Almost 80% of FHA's purchase-loan borrowers in 2009 are first-time homebuyers
  – Almost 50% of all first-time buyers in the housing market in Q2 2009 used FHA loans
- With current low interest rates, borrowers who refinanced to FHA fixed-rate loans in FY 2009 saved an average of $130 per month, an estimated total annual savings of $1.3 billion

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Your Door to FHA HOMEOWNERSHIP

FHA Is Just One Piece Of The Economic Puzzle

- Making Home Affordable – Helping to prevent foreclosures
- Financial Stability Plan – Bringing private capital back into the market
- The Recovery Act – Saving and creating jobs, helping to stimulate economic growth

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Factors That Affected This Year's Forecast Compared to Fiscal Year 2008 Forecast

Factor	Net Impact Compared to FY2008
Housing price forecast impact on net claim rates	- $9.8 billion
Housing price forecast impact on loss severity rates	- $6.4 billion
Lower future interest rates	- $2.2 billion
Volume and improved quality of FY 2009 business	+ $2.4 billion

MMI Fund Economic Value and Capital Ratio Calculations for FY 2009 Including FHA Single Family and HECM Programs (all dollars are in millions)

	FY 2008	FY 2009 Activity and End-of-Year Positions		
	MMI Fund[a]	Single Family	HECM[b]	MMI Fund
Beginning-of-Year Positions[c]				
Cash	$ 9,210			
Investments	19,244			
Properties and Mortgages	2,261			
Other Assets and Receivables	127			
Total Assets	$ 30,842			
Liabilities (Accounts Payables)	3,639			
Net Capital Resources	$ 27,203	$ 27,203		$ 27,203
Actuarial Calculations[d]				
Net Gain from Investments		$ 386	$ 0	$ 386
Net Insurance Income		2,516	614	3,130
Expected Recoveries on Assigned HECM Mortgages[e]		0	0	0
Capital Resources at End-of-Year		**$30,105**	**$ 614**	**$30,719**
Present Value of Future Cash Flows on Outstanding Insurance		(27,373)	295	(27,078)
Economic Net Worth	**$ 12,908**	**$ 2,732**	**$ 909**	**$ 3,641**
End-of-Year Unamortized Insurance-In-Force[f]	$ 429,634	$686,263	$28,696	$714,959
Capital Ratio Using Unamortized Insurance-in-Force	**3.00%**	**0.40%**	**3.17%**	**0.51%**
End-of-year Amortized Insurance-in-Force[g]	$ 401,461	$656,012	$28,696	$684,708
Capital Ratio Using Amortized Insurance-in-Force[h]	**3.22%**	**0.42%**	**3.17%**	**0.53 %**

[e]There are at present no assigned mortgages from HECMs in the MMI Fund (FY 2009 endorsements).
[f]Unamortized Insurance-in-Force represents original loan balances for forward loans and maximum claim amounts for HECM.
[g]Amortized Insurance-in-Force represents outstanding loan balances for forward loans and maximum claim amounts for HECM.

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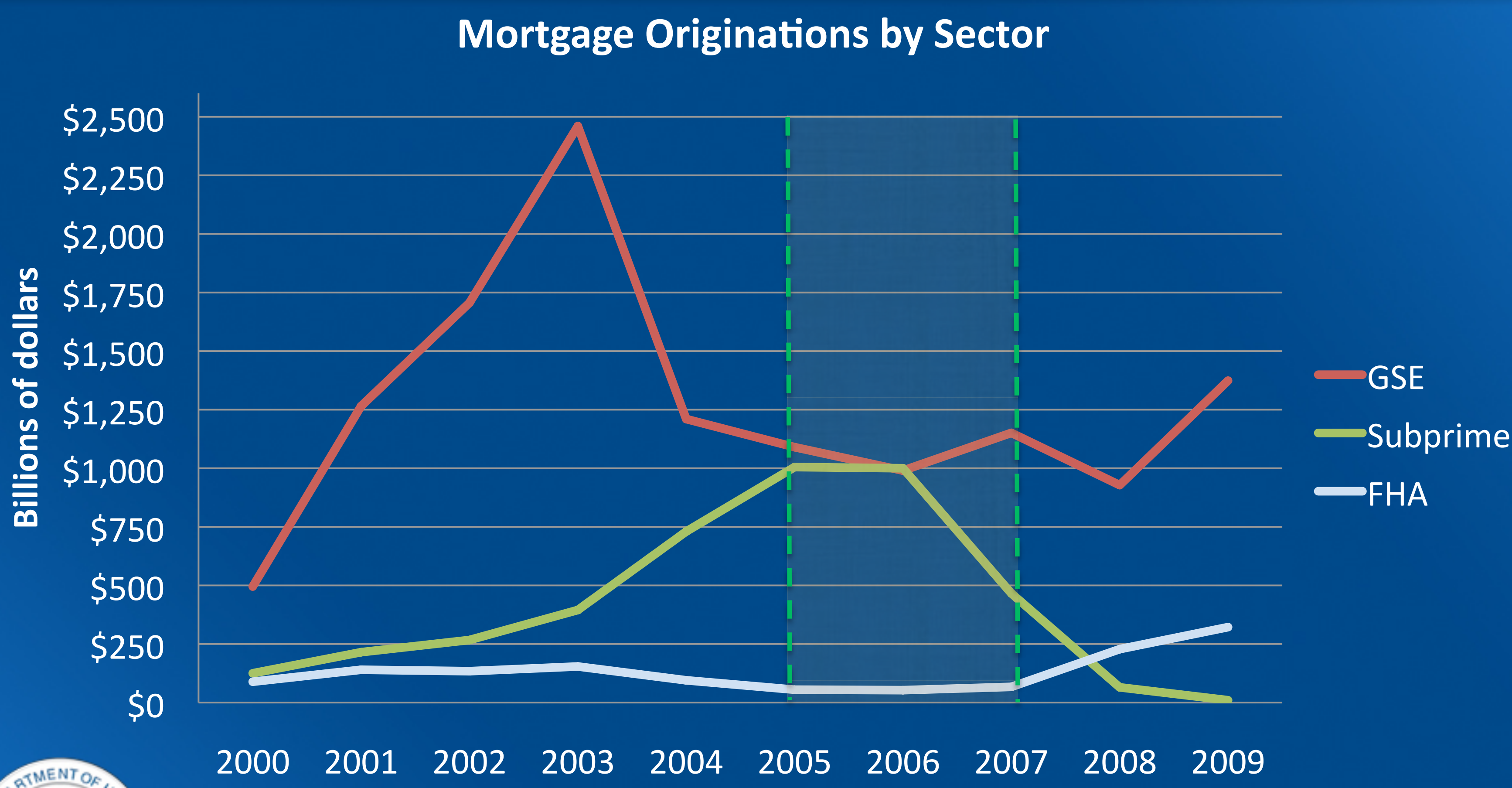
FHA Is Much Smaller Than The GSEs, Particularly in the Worst Years of the Housing Bubble



Shaded Area indicates peaks of house price growth and house prices nationally

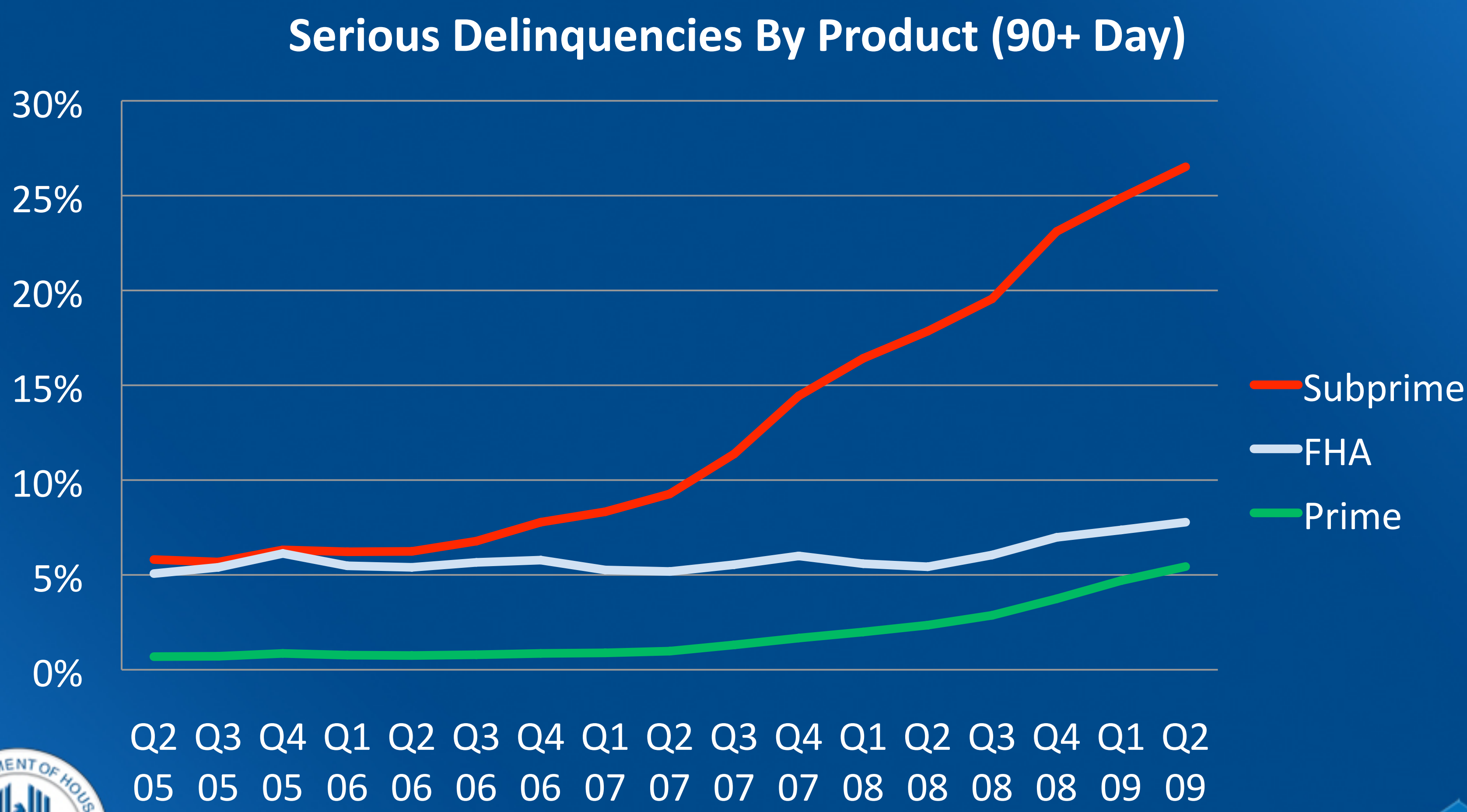
Source: Inside Mortgage Publications
Note: Volume in 2009 has been estimated from first half of 2009 numbers.

Despite the High LTVs Of FHA Loans, FHA Has Different Characteristics Than Subprime or Alt-A Loans

Loan Characteristic	FHA	Subprime and Alt-A
Fully documented	✓	<60% subprime, Alt-A <20%
Owner-occupied only	✓	✘
Fixed-rate loans	99%	33%
Unverified income	✘	✓
Teaser rates with resets	✘	✓
Interest only	✘	✓

Source: FHA; Barclays Capital "Mortgage Credit Tracker" August 2009.
Subprime and Alt-A statistics for 2007

Subprime Delinquencies Are 240% Higher Than FHA

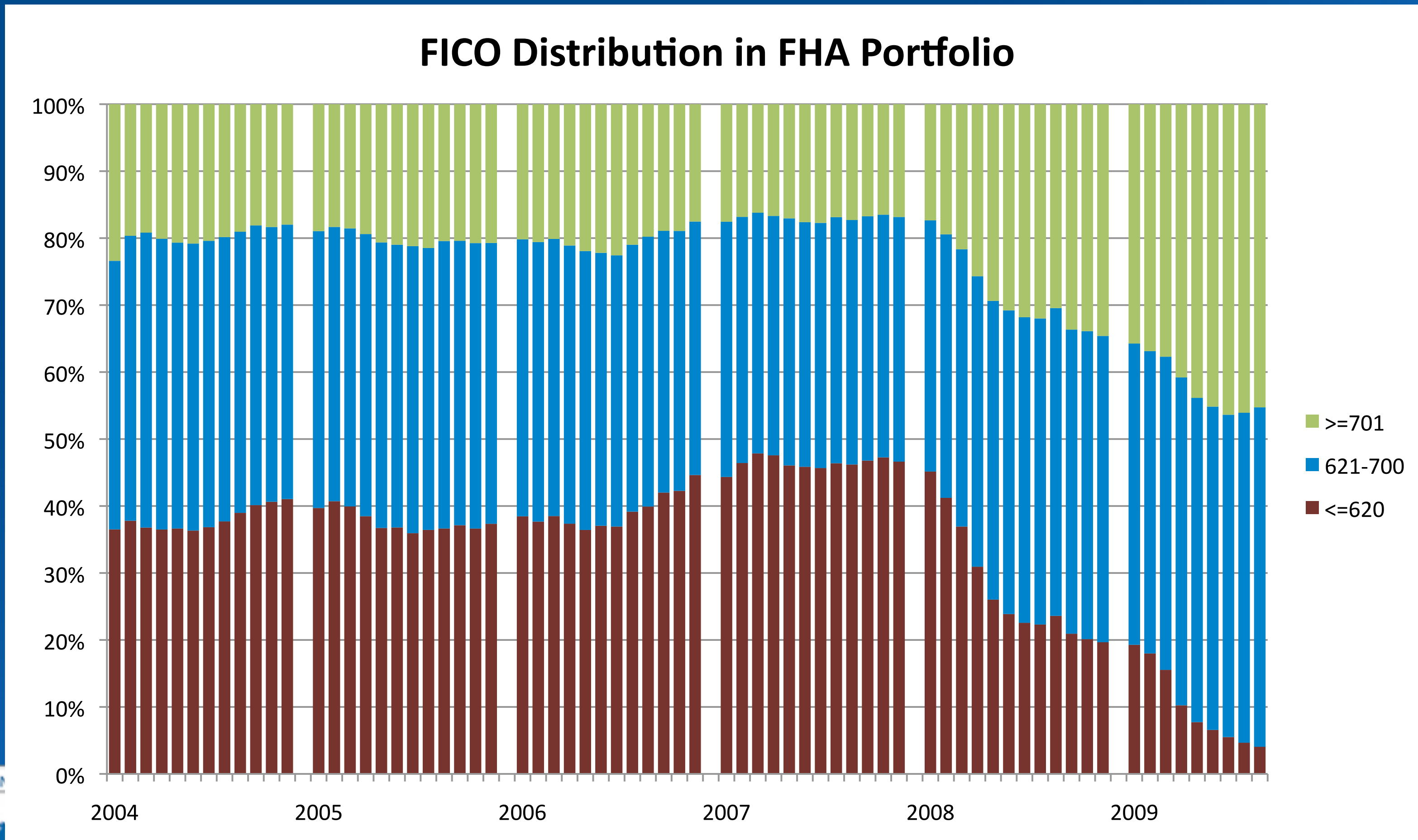


Source: Mortgage Bankers Association National Delinquency Survey, 2nd Quarter 2009

Seller-Financed Downpayment Assistance Loans Were FHA's Most Troubled Loans

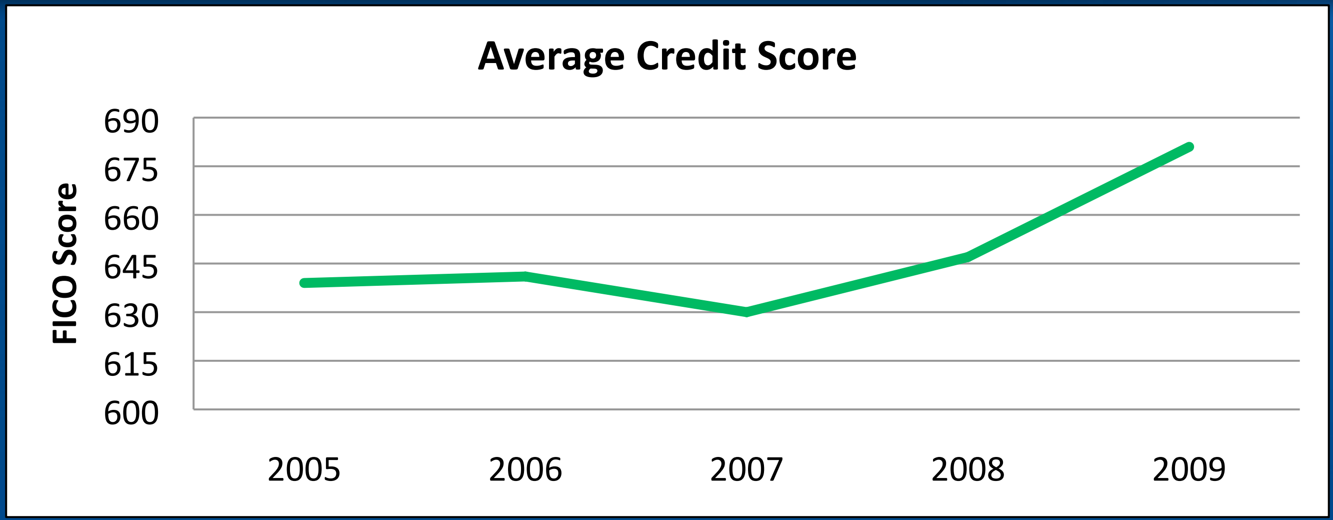
- Seller-financed downpayment assistance (SFDPA) loans were FHA's most substantial pool of troubled loans
  - Structure of program encouraged fraud and abuse
  - SFDPA loans have claim rates 2.5 to 3 times greater than non-SFDPA loans
- Congress stopped SFDPA loans in 2008 through passage of the Housing and Economic Recovery Act
- The actuarial review estimates that SFDPA loans will cost FHA an additional $10.4 billion in the future, on top of losses already sustained
- Without SFDPA loans, the capital reserve ratio would be estimated to be 2.0%

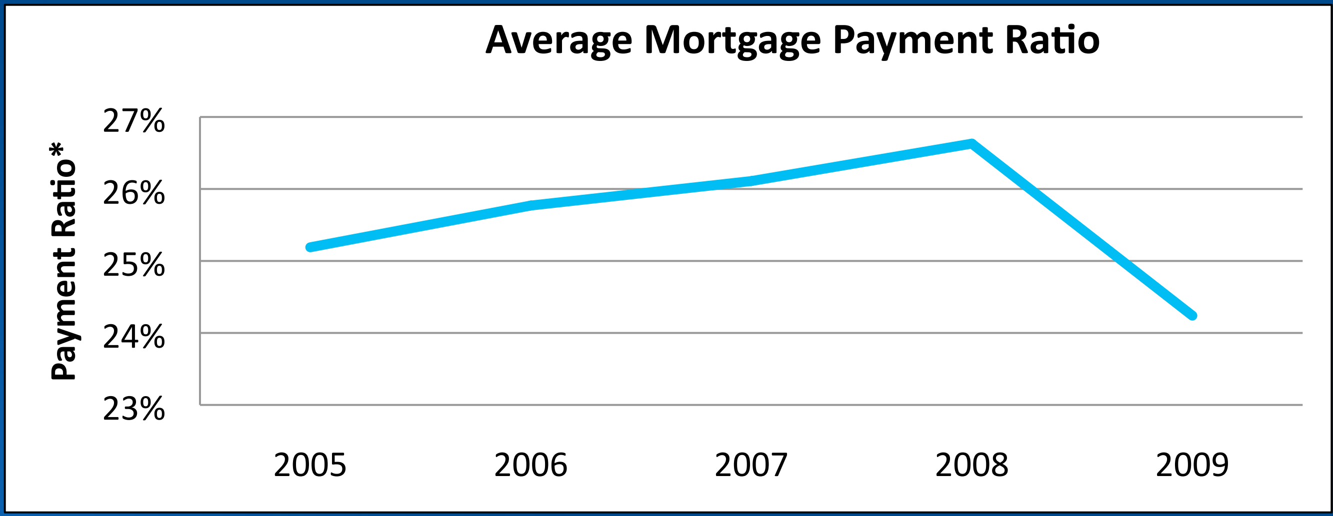
FHA's FICO Score Distribution Has Improved



Source: US Department of HUD/FHA

For Loans Made In FY 2010, The Actuarial Review Base Case Projects That FHA Will Earn More Than $5B Due To Higher Loan Quality





*Mortgage Payment Ratio is a ratio of monthly mortgage payment to monthly borrower income
Source: US Department of HUD/FHA

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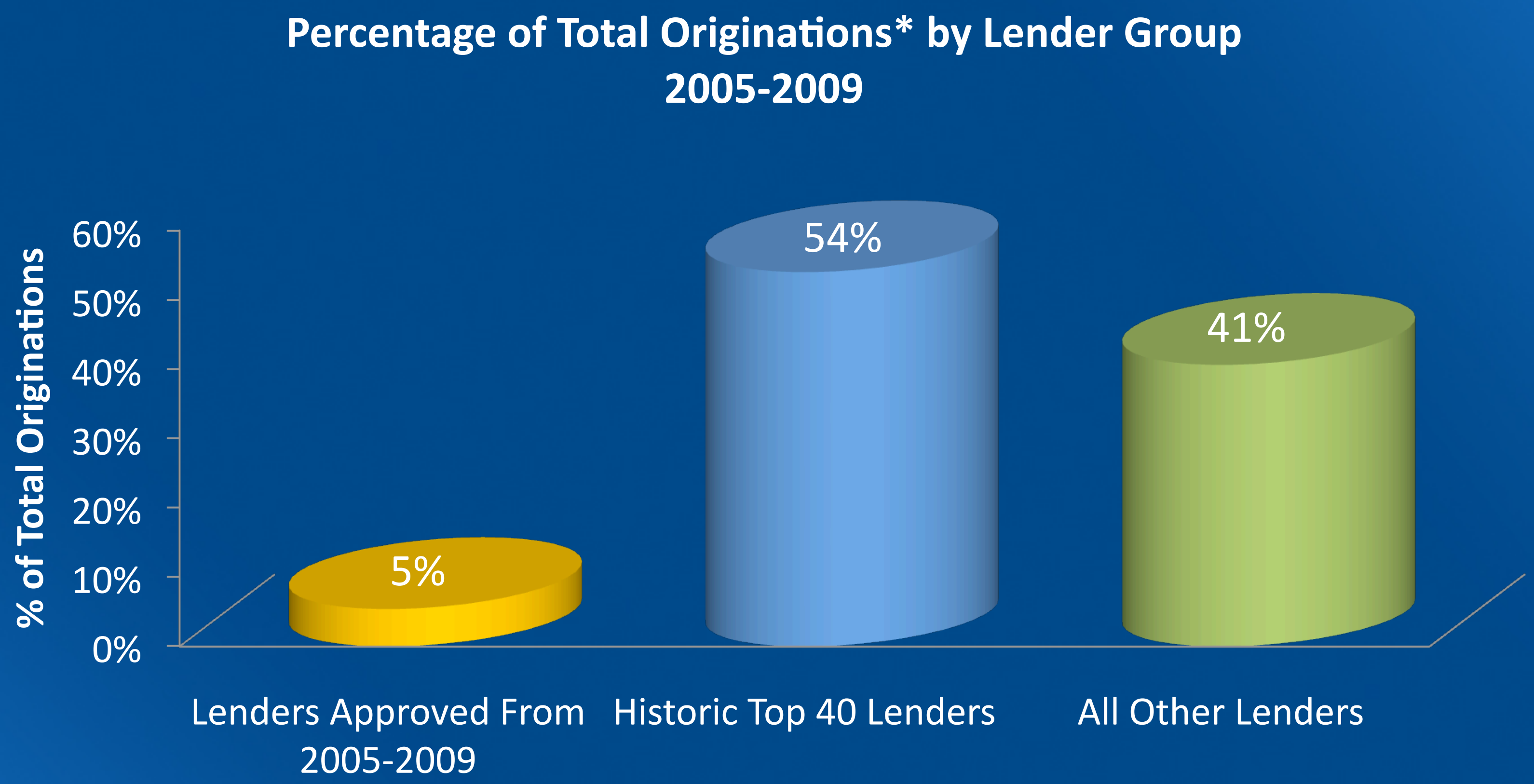
Real Risks and Real Reforms

- Risk: Significant growth of FHA portfolio
- Reforms:
  - Critical focus on risk management throughout organization
  - Hired FHA's first Chief Risk Officer and new Deputy Assistant Secretary for Single Family Housing
  - Increased staffing and technical capacity
  - Implementing new technology systems
  - Additional policy changes are under review to address current economic conditions

Real Risks and Real Reforms

- Risk: Migration of subprime lenders to FHA
- Reforms:
  - FHA has steeply increased enforcement
    - Suspended Taylor, Bean and Whitaker and 7 other lenders
    - Recent actions against Lend America and Financial Mortgage USA
  - Increased funding for anti-fraud tools
  - Recent counterparty risk management and other credit policy changes

New Lenders Represent Small Percentage Of Risk



- More than half of loans with historic top 40
- Just over 5% are attributed to newly approved lenders

Source: HUD/FHA; *% of Origination loan count of direct endorsement originations over 5 fiscal years

Real Risks and Real Reforms

- Risk: Economic decline beyond base-case scenario used by actuaries, including lower house prices, would further erode remaining capital and delay recovery of capital ratio
- Reforms:
  - Continuous monitoring of delinquency, default, and economic conditions with improved data-mining
  - Tightened rules for appraisals, streamline refinances, and lender approvals
  - Reduced cash take-out allowances on reverse mortgages
  - Added FHA-HAMP to loss mitigation program to prevent foreclosures
  - FHA is reviewing other program elements that may be changed in response to economic conditions

Real Risks and Real Reforms

- Risk: Borrower payment and default patterns in the current environment may change from historic patterns
- Reforms:
  - The reserves held in the financing account as a result of this year's actuarial review are based on historically high rates of expected future claim rates and loss severity
  - FHA will monitor changes in default patterns and net claim costs closely, and is prepared to respond quickly to any significant deviations from forecasts

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