

## **FHA's Office of Single Family Housing**

### **FHA's Supplemental Performance Metric Fact Sheet**

#### **Background**

On May 13, 2014, FHA proposed the development of a Supplemental Performance Metric— one component of FHA's *Blueprint for Access to Credit* initiative. As of August 17, 2015, the Supplemental Performance Metric was implemented and is available for view in FHA's Neighborhood Watch Early Warning System. This metric is designed to help mitigate adverse selection away from borrowers with certain credit profiles and encourage the extension of homeownership opportunities to underserved segments of the market. The metric provides mortgagees and FHA with more insight into the performance of loans in three distinct credit bands: <640, 640 – 680, and >680.

#### **Compare Ratio**

FHA currently calculates a Compare Ratio for all FHA-approved lenders, which compares the rate of defaults and claims for insured single family mortgage loans originated or underwritten by the mortgagee in a specific geographic area with the rate of defaults and claims for other mortgagees originating or underwriting insured single family mortgage loans in that same area.

The Compare Ratio is used to execute FHA's Credit Watch Termination Initiative, in which lenders with excessive default and claim rates compared to their peers may have their authority to originate and/or underwrite FHA loans terminated. In considering whether or not a lender's authority should be terminated, FHA evaluates all lenders with a compare ratio above 150%, and may propose termination for those with compare ratios that meet or exceed 200% of the default and claim rate within the geographic area served by a HUD field office, and whose default and claim rate exceeds the national average.

The Compare Ratio is also used to evaluate lender performance in determining eligibility for Lender Insurance (LI) authority. Lenders seeking LI authority must possess and maintain an overall compare ratio of 150% or less for the states in which the lender underwrites FHA-insured mortgage loans. FHA evaluates lender performance on a quarterly basis and may terminate a lender's LI authority if their compare ratio exceeds 150% at the time of evaluation.

#### **Supplemental Performance Metric**

The Supplemental Performance Metric responds to lender concerns about the Compare Ratio being a comparison to one's peers rather than to FHA's risk tolerance. The metric is intended to address the difficulty of sub-680 credit score borrowers' ability to access credit, especially for those that are below 640. This new metric provides more nuanced insight into a lender's specific performance and encourages lenders to serve creditworthy underserved borrowers.

#### **Methodology**

Based on feedback received on the initial proposal, FHA decided to use a mix-adjusted default and claim rate (Mix Adjusted SDQ Rate) instead of a weighted average default and claim rate in its calculation. The Mix Adjusted SDQ Rate is the percentage of loans originated or underwritten by

the lender within each credit score band multiplied by the benchmark FHA default and claim rate for those same credit score bands. The lender's default and claim rate (SDQ Rate) is divided by the new Mix-Adjusted SDQ Rate to calculate the Supplemental Performance Metric. The loan populations used to develop the Supplemental Performance Metric are the same as those used to calculate the Compare Ratio.

Distribution and SDQ Rates					Weighted SDQ and Scores		
	<640	640-680	>680	SDQ Rate	Mix-Adjusted SDQ Rate	Supplemental Metric Ratio	Compare Ratio
<b>Lender</b>					<b>1.5%</b>	<b>120%</b>	<b>150%</b>
Mix	30%	30%	40%	1.8%			
SDQ	2.4%	2.3%	0.9%				
<b>Benchmark Portfolio</b>					<b>1.6%</b>		
Mix	25%	50%	25%	1.6%			
SDQ	3.0%	1.5%	0.4%				
<b>FHA Portfolio</b>					<b>1.2%</b>	<b>100%</b>	
Mix	12%	42%	46%	1.2%			
SDQ	2.0%	1.7%	0.5%				

The Credit Watch Termination Initiative is based on a two-pronged evaluation:

- The lender's Compare Ratio exceeds 200% of the default and claim rate within the geographic area served by a HUD field office, **and**
- The lender's default and claim rate exceeds the national default and claim rate.

This initial evaluation will not change. A lender's Supplemental Performance Metric will be considered as an additional factor in the total evaluation after the initial evaluation has triggered possible termination. FHA will examine this ratio when considering further action related to Credit Watch Termination or Lender Insurance.

If a lender's SDQ Rate is less than 125% of its Mix Adjusted SDQ Rate, as shown in the Supplemental Metric Performance Metric, this will be a consideration to not take further action under Credit Watch or the Lender Insurance termination initiatives, along with other factors, such as de minimus volumes. Alternatively, if the lender's SDQ Rate is equal to or greater than 125% of its Mix Adjusted SDQ Rate, it may be a consideration to move forward under the Credit Watch Termination Initiative.

In the public view in Neighborhood Watch, users will be able to see the Supplemental Performance Metric Score for a lender as an additional column following the Compare Ratio, and would be able to access a

definition of the metric and the display of FHA's targeted risk mix and default and claim rate. In the lender view, mortgagees will be able to drill down on their own Supplemental Performance Metric to view the performance of the loans they originated/underwrote within each credit score band, in addition to viewing the performance of the FHA portfolio within those same bands.