

Analysis of HUD/FHA Guarantees for HECM Credit Lines

Ongoing Research Project at University of California
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HUD/FHA Guarantees and the MMI Fund

- HUD/FHA guarantees are critical to the long term viability of the HECM market as well as the effectiveness of retirement income strategies employed by “house rich” retirees utilizing HECM’s
- FHA guarantees are funded via up front and ongoing “Mortgage Insurance Premiums” (MIP’s) set by HUD.
- MIP’s historically set at 0.5% (of home value) up front and 1.25% (of outstanding loan balance) ongoing, but effective 10/2/17, MIP rates changed to 2.0% up front and 0.5% ongoing.
- MIP’s held in MMI Fund whose solvency has recently become a concern
- 2016 valuation (performed by IFE) showed a long term \$7.8 billion deficit, while 2017 valuation, (performed by Pinnacle Associates) showed a deficit of \$14.2 billion

The Pinnacle Valuation of MMI Fund solvency

- Major focus of Pinnacle analysis was on evaluating short term risks and funding shortfall associated with current portfolio.
- Closed group valuation focuses on status of existing HECM's and incorporates pre 2017 MIP structure
- Includes detailed review of home price volatility, borrower "default" experience (e.g. via failure to pay property tax) and the transaction costs associated with a forced sale.
- Current borrower profile and behavioral assumptions (e.g. HECM drawdown timing and likelihood of property tax/insurance default) seem inconsistent with likely market/demographic trends.

Outline of Current Research Project

- Built new model to test adequacy of the current MIP structure to fund the promised HUD/FHA guarantees and potentially eliminate existing MMI Fund deficit.
- Utilizes long term (retirement) actuarial principles and is designed to perform an Open Group valuation
- Can highlight impact of new MIP rates, possible changes in borrower profile and broader use of alternative LOC drawdown strategies (e.g. the “coordinated strategy”).
- Basic model has been constructed and tested on publicly available data on HECM’s initiated 1989-2011
- Preliminary findings indicate reasons to be optimistic about the future solvency of the MMI Fund

Preliminary Findings

- Analysis of 158,000 HECM's that terminated between 2005 and 2011 indicate that such terminations would have produced a **net gain** for MMI Fund had new MIP rates been in effect when HECM's initiated
- Significant differences in potential claims found by size of HECM (higher HECM values produced lower claims)
- Potentially longer duration of HECM and lower property tax/insurance default rates (if borrower profile changes as expected) suggest future HECM's will produce a surplus for the MMI Fund
- If future HECM's produce surplus **and** HECM volume grows significantly then projected deficit of MMI Fund will potentially disappear