SPECIAL REPORT

Lender Perspectives on FHA's Declining Market Share

Bernadette Kogler,
Ann Schnare and Tim Willis,
of the Hollister Group, LLC

RESEARCH INSTITUTE for HOUSING AMERICA

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

Research Institute for Housing America

Board of Trustees

Chair
Teresa Bryce, Esq.
Nexstar Financial Corporation

Kieran P. Quinn
Column Financial, Inc.

Andrew D. Woodward

Edward L. Hurley
Wachovia Securities

Stacey Berger
Midland Loan Services, Inc./PNC Real Estate Finance

Staff

Douglas G. Duncan, Ph.D.
Senior Vice President, Research and Business Development
Chief Economist
Mortgage Bankers Association

Jay Brinkmann, Ph.D.
Vice President, Research and Economics
Mortgage Bankers Association

Michael Fratantoni, Ph.D.
Senior Director, Single Family Research and Economics
Mortgage Bankers Association

Lender Perspectives on FHA's Declining Market Share

Bernadette Kogler, Ann Schnare
and Tim Willis, of the Hollister Group, LLC

August 2006

© Research Institute for Housing America 2006. All rights reserved.

Table of Contents

Executive Summary 1
Introduction 3
Where is the Business Going? 9
Factors Driving the Market Shift 11
Product Mix 12
Processing Requirements and Costs 14
  Processing Costs 14
  Processing Time 15
  Processing Inefficiencies 16
  Recent HUD Initiatives 21
Risk versus Profitability 21
  Credit Risk 23
  Reputation (Business) Risk 24
  Indemnification Risk 25
Summary and Implications 27
Appendix: Comprehensive Survey Results 29

Executive Summary

Although many lenders continue to view Federal Housing Administration (FHA) financing as the best option for some consumers, FHA's market share has experienced significant erosion in recent years. The steep decline in FHA lending has been attributed to a variety of factors, including a loosening of conventional underwriting guidelines, the growth of the subprime market, the inflexibility of the FHA product line, and the labor-intensity of FHA processing requirements. Further, many speculate that adverse selection is leading to increased risk exposure for FHA products.

This study presents the results of a lender survey designed to summarize perspectives from a cross section of lenders regarding the relative importance of different factors. The survey was sponsored by the Research Institute for Housing America (RIHA) and completed by 61 lending institutions of varying size and with varying degrees of experience with FHA.

The great majority of survey respondents perceived that FHA's declining market share is the result of expanding conventional conforming and subprime markets, which now offer a broad range of alternative products. When asked where the business was going, respondents confirmed the generally held belief that FHA was losing market share at both the upper and lower ends of the credit spectrum.

While FHA was once the dominant provider in the low-down-payment market, Fannie Mae's and Freddie Mac's (the Agencies) movement into higher-Loan-to-Value (LTV) products combined with their expanded credit guidelines was seen as a major driver of FHA's declining market share. However, Government Sponsored Enterprise (GSE) market share has also declined in the past two years, with conventional conforming originations declining 9.8 percent in 2005 compared to 2004.[1] Indeed, over one-third of respondents also reported

1 Inside Mortgage Finance, February 24, 2006.

that potential FHA borrowers were turning to the subprime market and "other" alternative products. Lenders reported that innovations in alternative products, such as interest-only ARMs, payment-option ARMs and stated income loans — products that are not necessarily associated with lower-credit-quality borrowers — have also contributed to the movement away from FHA products. In fact, lenders viewed FHA's lack of a zero-down-payment product as the most significant weakness in its existing product suite.

The expected duration of the shift away from FHA depends on where the lost business is going. While it was reported that the shift to the Agencies is believed to be a secular phenomenon, gains in the subprime market were seen as a cyclical event that could diminish when credit spreads widen. Despite the expansion of other product types, however, most lenders agree that FHA remains a good option for many homebuyers with marginal credit and limited access to down payment funds.

In addition to weaknesses in product offerings, the majority of lenders reported that origination costs were significantly higher for FHA loans when compared to Agency loans. While every phase of the origination process was viewed as contributing to these higher costs, lenders' estimates of processing times suggest that the greatest problems occur in the approval stage. Costs were not necessarily noted as higher when compared to subprime loans.

In addition to seeing higher relative costs, most lenders reported that they were not being adequately compensated for the higher risks associated with FHA lending. In fact, most lenders believed that their indemnification risk was growing with the deterioration of their FHA portfolio and was now significantly higher than the repurchase risk associated with Agency loans. While many lenders believed that FHA overall remains more profitable than other types of lending, study participants primarily attributed this higher profitability to higher servicing fees and slower prepayment speeds. Premiums for loans made to Community Reinvestment Act (CRA)-related customers were also viewed as contributing to profitability.

The Department of House and Urban Development's (HUD) recently announced Lender Insurance program and new appraisal protocols should help to address many of the processing issues identified by survey respondents. However, many important issues remain unresolved, including the need for more competitive product offerings, as well as the need to mitigate the substantial risks that lenders believe they face in originating and servicing FHA loans. While process improvements can help to level the playing field, lenders perceive that FHA could take additional steps to improve its competitive position with respect to the Agencies and subprime markets to avoid becoming the "last resort." The survey results suggest that, in terms of product offerings, the best way to improve FHA's market share would be to match the down payment and equity requirements of other market offerings, including Agency offerings.

Introduction

The Federal Housing Administration's (FHA) share of single family lending has dropped precipitously in the past five years. Between 2000 and 2004, for example, FHA's share of single family originations declined from 16 percent[2] to 5 percent[3] (see Figure 1), while its share of total mortgage debt outstanding fell from 20 percent to 9 percent. There are several market dynamics that are driving this trend. Between 2000 and 2004, conventional prime loans (including private, Fannie Mae and Freddie Mac (Agency) loans) as a share of total loans outstanding increased from 69 percent to 76 percent, while the subprime share increased from 2 percent to 11 percent.[4] Despite the notion that much of FHA product is now going towards the Agency market, Government Sponsored Enterprise (GSE) share declined during the past two years, with conventional conforming originations declining 9.8 percent in 2005 from 2004.[5] Further, the conventional conforming market declined to 35 percent of total originations from 62 percent in 2003.[6] This trend suggests that much of the recent surge in product has been in the form of Alt-A and subprime. In fact, Alt-A market share increased to 12.5 percent in 2005, and subprime market share increased to 20 percent in 2005.[7]

2 Source: MBA Analysis of Federal Financial Institutions Examination Council (FFIEC) Data.

3 Source: MBA Year-end Market Activity Survey.

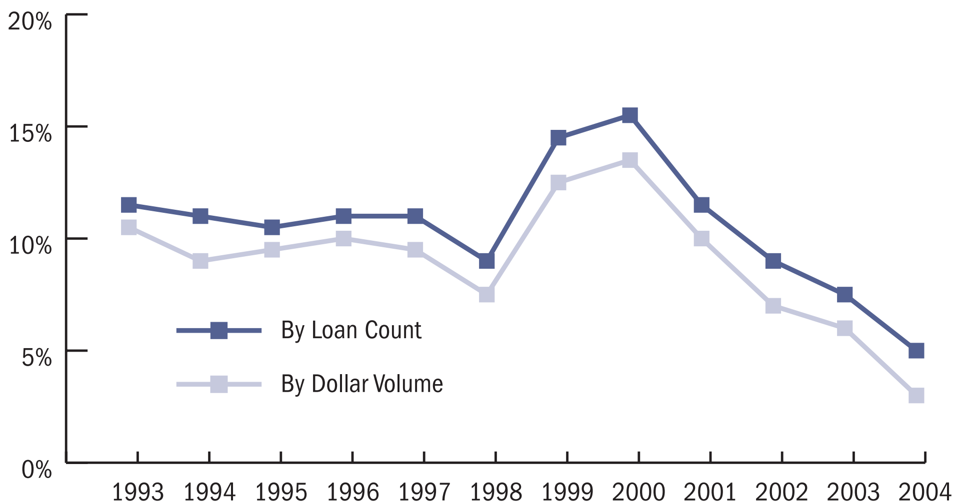
4 Source: MBA National Delinquency Survey.

5 Inside Mortgage Finance, February 24, 2006.

6 Inside Mortgage Finance, February 24, 2006.

7 Inside Mortgage Finance, February 24, 2006.

FIGURE 1: FHA MARKET SHARE (HISTORICAL)

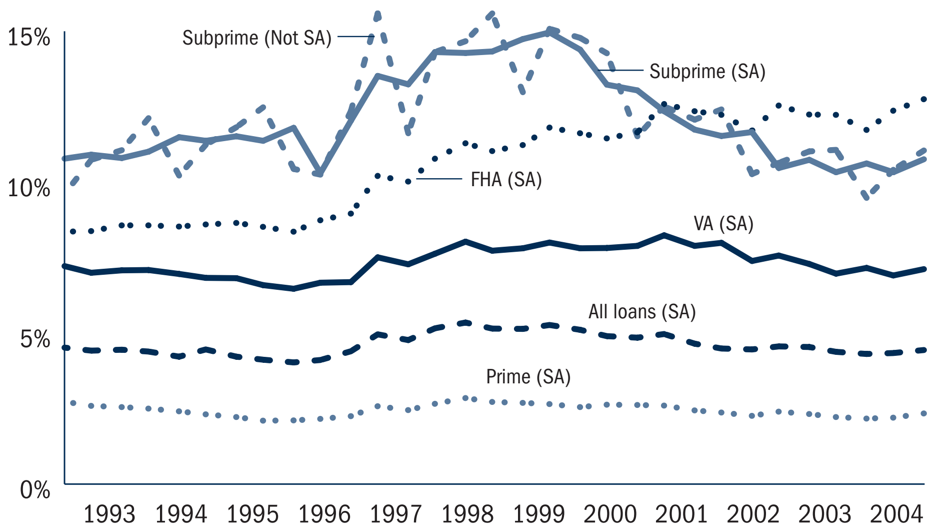


Source: HMDA

In the past, FHA's market share has typically declined during refinancing waves — for example, 1992–1993 and 1998 — and risen in purchase money markets — for example, in the mid-1990s and 1999–2000. This cyclical pattern reflects the caps imposed on the size of FHA mortgages and the product's traditional appeal to first time homebuyers. However, as shown in Figure 1, the extent of the recent deterioration in FHA's market share appears to be unprecedented and suggests that more fundamental forces may be at work.

Contributing to the perceived increase in FHA risk has been rising FHA delinquency and foreclosure rates. As shown in Figure 2, roughly 12 percent of the FHA book was delinquent in the third quarter of 2005, and about 2.5 percent was in foreclosure. This marked deterioration in the performance of FHA loans contrasts with the patterns observed in the overall market, where delinquency and foreclosure rates have remained relatively low. In 2005, delinquency rates on FHA mortgages were about 7 percentage points higher than they were on all loans, compared to a spread of 4 percent in 1998. In fact, the delinquency rates on FHA mortgages now exceed those experienced on subprime loans.

FIGURE 2: DELINQUENCY RATES: TOTAL LOANS PAST DUE BY LOAN TYPE, QUARTERLY



Source: MBA's National Delinquency Survey

MBA Member Survey

This study presents the results of a lender survey designed to gather industry perspectives on the principal reasons for the declining FHA share. The survey was sponsored by the Research Institute for Housing America (RIHA) and administered through an Internet-based questionnaire developed in cooperation with six of the top 50 FHA lenders. Nearly all of these lenders have seen their FHA volumes decline sharply in the past five years. The findings presented here reflect the formal survey results, as well as the insights gained through extensive discussions with these large FHA lenders.

Objectives

The primary objective of the survey was to elicit and quantify lender views on the various factors that are impeding their ability or willingness to originate FHA loans. The study sought to identify and summarize lender experience with the FHA program as well as lender perceptions of the incremental costs and risks when compared to conventional or alternative market products, such as Alt-A or subprime. The study also focused on assessing the relative importance of these costs and risks. Lender perspectives presented include benefits and concerns cited by the various participants. This report highlights

the viewpoints of various industry participants and their specific business, operational, financial, and strategic concerns. The survey examined four broadly defined areas:

- Product Offerings
- Processing Requirements and Costs
- Profitability
- Risk

In each of these areas, lenders were asked to rank on a scale of one to five a variety of factors thought to be contributing to the declining of FHA share. A copy of the questionnaire and lender responses is presented in the Appendix.

The survey does not address the admittedly complex issues associated with FHA reform. A number of perceived weaknesses in FHA programs are statutory, and cannot be changed without Congressional authorization; others are regulatory and could be addressed by HUD in the absence of legislation, albeit with varying degrees of difficulty.

Methodology

The survey was sent to 180 MBA members, including 54 who were among the top 100 FHA lenders, as well as 126 smaller organizations whose MBA profile reflected an interest in government lending. A total of 64 respondents from 61 lending institutions responded to the survey (three lenders had two respondents.) The broader electronic survey was supplemented with a series of one-on-one telephone interviews with six lending institutions. During the interviews, lenders described the key issues facing current and former FHA lenders. Viewpoints of these industry participants are incorporated throughout this report.

As shown in Table 1, the survey participant sample is broadly representative of the types of institutions that are engaged in FHA lending. Although the sample includes some of the country's largest FHA lenders — in 2004 the top 10 FHA lenders accounted for more than one-third of all FHA volume — the majority of respondents are relatively small, as the majority of FHA lenders. Survey respondents also differ with respect to their relative concentration in FHA lending.

TABLE 1: CHARACTERISTICS OF SURVEY PARTICIPANTS

Participation by 2004 FHA Production Volume

	No. of Survey Participants
Top 10	5
Top 11-50	4
Top 51-100	5
Not in Top 100	44
Unknown/Anonymous	3

FHA as Percentage of Lender's Production

	No. of Survey Participants
Over 50% of Lender Volume	3
25 - 50% of Lender Volume	15
10 - 50% of Lender Volume	18
Under 10% of Lender Volume	21
Unknown/Not Reported	4

While three lenders indicated that FHA accounted for more than 50 percent of their 2004 origination volumes, 21 reported that their current FHA share was less than 10 percent. During the course of the analysis, the data was parsed in an effort to compare the responses of lenders with similar FHA production volumes. Very little discernible difference was noted among these groups. As a result, all survey data is presented in aggregate.

Where is the Business Going?

The remainder of this report is organized along side the major topic areas covered by the survey. We begin by presenting lenders' opinions on where the FHA business is going, i.e., to the conventional market, the subprime market, or some combination of the two. We then present respondents views on the major factors that affect product offerings and the extent to which product mix, processing costs, profitability and risk are contributing to declining FHA originations. The final section of the report summarizes the major findings and their implications for FHA.

Despite the diversity in size and specialization in FHA products, 86 percent of survey respondents reported a decline in FHA originations over the past five years. As shown in Table 2, the shift away from FHA was quite pronounced. Between 1999 and 2004, for example, lenders that reported a specialization in FHA product, i.e., FHA loans accounted for more than 50 percent of overall volume, declined from 23 percent to 5 percent. Over the same period of time, the proportion reporting an FHA share below 10 percent grew from 11 percent to 34 percent.

TABLE 2: FHA "SPECIALIZATION"

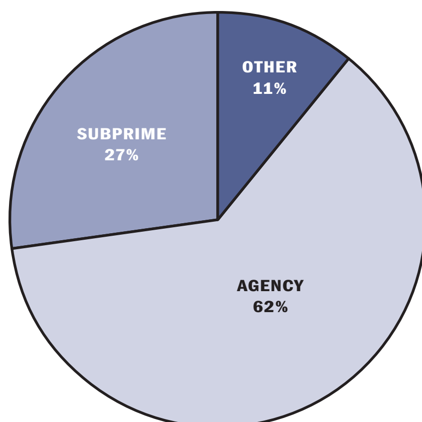
FHA as a Percentage of Participant Lender's Production

	% of Survey Participants 2004	% of Survey Participants 1999
Over 50% of Lender Volume	5%	23%
25 – 50% of Lender Volume	24%	31%
10 – 50% of Lender Volume	29%	26%
Under 10% of Lender Volume	34%	11%
Unknown	8%	10%

When asked where the business was going, respondents confirmed the generally held belief that FHA was losing market share at both the upper and lower ends of the credit spectrum. However, most believed that the majority of FHA business was going to the Agencies. As shown in Figure 3, survey participants estimated that an average of 62 percent of their "lost" FHA volume — loans to consumers who, in the past, would have been likely candidates for FHA loans — is now being served by conventional Agency products. However, Agency originations have also declined over the same period. Indeed, over one-third of respondents reported that potential FHA borrowers were believed to be turning to the subprime market and "other" alternative products, such as Option ARMs.

The perceived loss of market share to the Agencies is puzzling in light of pricing advantages enjoyed by FHA-loans relative to comparative Agency products. For example, the pricing of an FHA loan with 97 percent loan-to-value (LTV) ratio is superior to that of a Fannie Mae "My Community Mortgage" at the same LTV. However, while FHA products are competitively priced at 97 percent LTV, there is no FHA product at any price to compete with 100 percent LTV loans, whose popularity has increased dramatically. Further, loans under FHA Down Payment Assistance Program (DAP) allow gifts which may be used for the down payment and reasonable and customary charges for closing costs, prepaid items, points, a home inspection, with home warranty insurance in accordance with policies of the primary lender. Unlike most family gifts however, DAP assistance is usually provided as an expense to the seller, contributing to higher overall costs.

FIGURE 3: PERCENTAGE OF FHA "LOST MARKET SHARE" TAKEN BY THE FOLLOWING:



The vast majority of respondents also believed that the decline in FHA's share was likely to continue with respect to Agency products. When asked if they thought that the decline in FHA was "merely a short term phenomenon," 90 percent of all respondents indicated that they "disagreed" or "strongly disagreed."

While 79 percent of respondents also believed that the compressed credit spreads — declines in yield differences between high and low-credit-quality borrowers — were contributing to the growth of the subprime market at the expense of FHA, opinions were mixed on what will happen when spreads increase. About 30 percent agreed with the statement, "The demand for FHA loans will pick up if credit spreads increase markedly." However, the remainder had no opinion (31 percent) or disagreed (39 percent).

These seemingly contradictory responses most likely reflect the shift of FHA product to two distinctly different markets. On one hand, the loss to the Agencies was seen as relatively permanent, primarily affecting borrowers with stronger credit histories. As described in more detail below, this shift has reduced the overall quality of the FHA book of business and increased the lenders' risk exposure. On the other hand, the shift to Alt-A and subprime products was viewed as more contingent on market conditions — including the current credit cycle.

Factors Driving the Market Shift

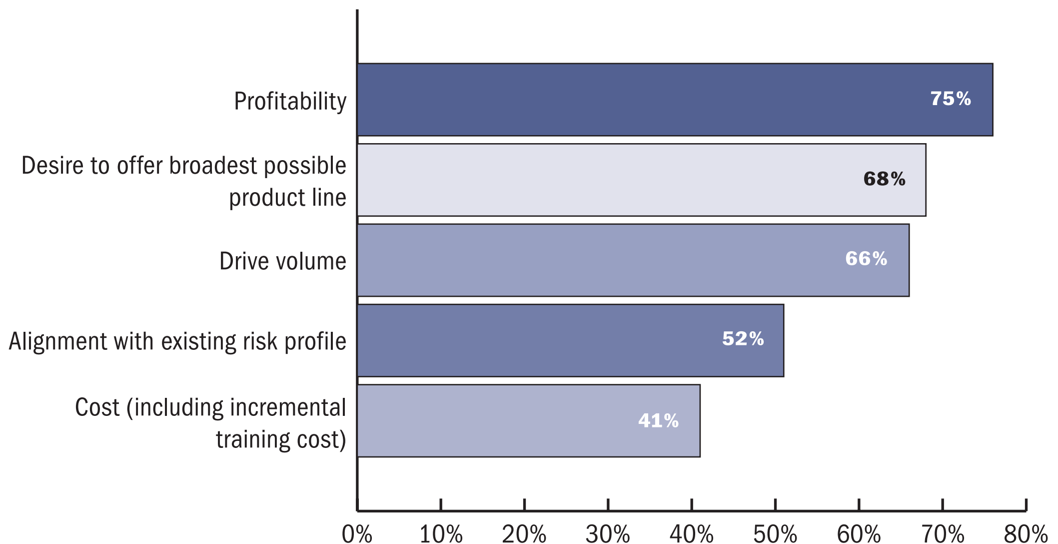
Numerous reasons have been cited in industry periodicals and discussion papers as contributing to the decline in FHA market share, including operational issues, legal risks, reputation risks, regulatory requirements, and associated costs. While survey results revealed that some issues were ultimately not of great concern, others were consistently cited as hurdles to FHA lending. Specifically, the comparative inflexibility of the FHA product

> "All the strong first time buyers with higher credit scores have better loan options [than FHA]."
> *—A Small FHA Lender*
>
> "FHA needs to better compete with the 100% and Alt A programs on all fronts." *—An FHA Specialist*

line, the labor-intensity of the process, and a perception of higher risk are all viewed as significant factors that have contributed to these trends.

To better understand the forces that are driving the current market shift, lenders were first asked to rank on a scale of one to five, five general factors that influence their product offerings, including but not limited to FHA loans. As shown in Figure 4, the principal driver of product offerings was clearly profitability, which was rated as "very important" or "critical" by 75 percent of survey respondents. Two-thirds of lenders also rated "the desire to offer the broadest range of products" and "drive volume" as significant or critical factors. While "alignment with existing risk profile" and "costs" also influenced lenders' offerings, they appear to play a less important role.

FIGURE 4: PERCENTAGE OF LENDERS CONSIDERING EACH OF THE FOLLOWING TO BE A "VERY IMPORTANT" OR "CRITICAL" DRIVER OF PRODUCT OFFERINGS



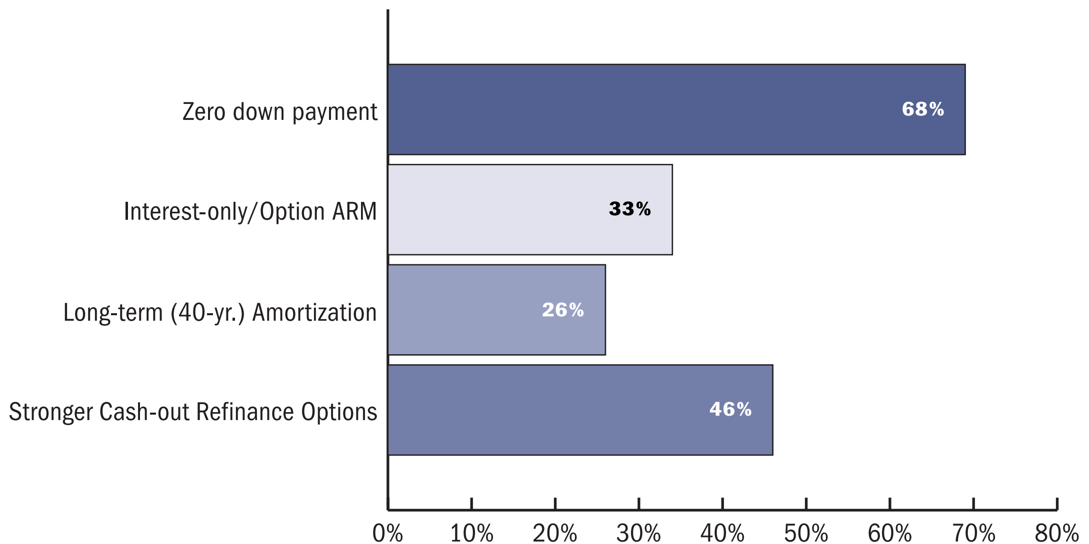
Product Mix

The overwhelming majority of survey participants believed that FHA's lack of product breadth was a major factor underlying its declining market share. Only 19 percent of respondents agreed with the statement, "The existing suite of FHA product meets market demand," while 68 percent "disagreed" or "strongly disagreed."

As shown in Figure 5, the lack of a zero-down payment mortgage — which is now available in both the Agency and subprime markets — was viewed as the most substantive

weakness of FHA's existing product offerings. Sixty-nine percent of survey respondents reported that the addition of a zero-down payment product to FHA's existing line would result in a "significant" or "major" increase in the number of FHA loans they originate. Furthermore, although not quantified within the survey, it was noted that FHA loan limits are a contributing factor to the declining FHA market, particularly along the coastal regions where home prices are appreciably higher and there is a corresponding abundance of subprime and alternative mortgage products.

FIGURE 5: PERCENTAGE OF LENDERS BELIEVING EACH OF THE FOLLOWING, IF OFFERED BY FHA, WOULD LEAD TO A "SIGNIFICANT" OR "MAJOR" INCREASE IN FHA PRODUCTION



Forty-six percent of respondents also believed that a stronger cash-out refinance program would make FHA programs significantly more competitive, particularly in the current interest rate environment. While FHA has a cash-out refinancing product, the loan amount had previously been capped at 85 percent of the home's appraised value. FHA's recent Mortgagee Letter 2005-43 cites that FHA will now insure a cash-out refinance of up to 95 percent of the appraiser's estimate of value. This letter was issued on October 31, 2005, after a majority of survey responses were received. The recently announced FHA change will address the once stark contrast to both the conventional-conforming and subprime markets, which offer products that allow loan-to-value ratios as high as 100 percent, and in some cases, even higher.

There was considerably less agreement on the potential impact of other products. For example, only 33 percent of respondents believed that "interest-only" and "option ARMs" would lead to a "significant" or "major" increase in their FHA volume. In fact, many industry observers believed the market for these products would diminish in importance

as a result of increased regulatory scrutiny and as higher short-term interest rates make them less attractive to borrowers. Likewise, only about 26 percent of survey respondents believed that the introduction of a 40-year product would have a significant affect on FHA's market share.

> "The most significant factors negatively affecting FHA production are... appraisal requirements and the reluctance of realtors to accept an FHA offer." *—A Top 10 FHA Lender*
>
> "I believe the excessive regulations and cumbersome processes actually are a deterrent to increased homeownership rather than a help to that goal." *—A Small FHA Lender*

To a large extent, the importance attached to a zero-down-payment option and a stronger refinancing product reflects the expansion of the conforming market at the expense of FHA. FHA was once the dominant player in the low-down payment market. Recent market innovations, however, have put FHA at a distinct disadvantage, making it less able to compete for the more credit-worthy borrowers. Indeed, most lenders believe this has led to a process of "adverse selection" that largely explains the declining performance of FHA loans. The survey results suggest that, in terms of product offerings, the best way to improve FHA's market share would be to match the down payment and equity requirements of other market offerings, including Agency offerings.

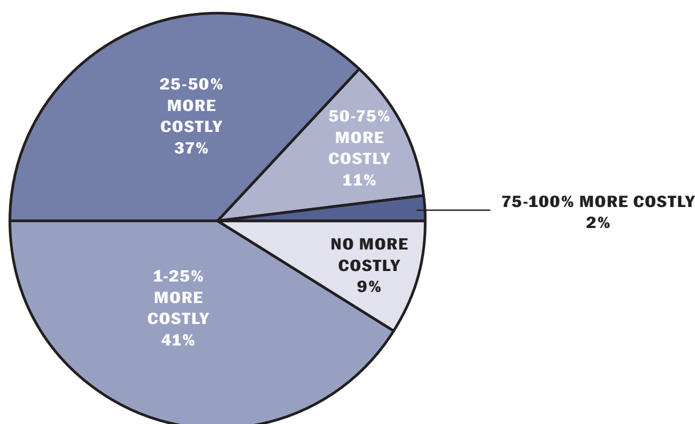
Processing Requirements and Costs

In addition to weaknesses in FHA's product offerings, lenders also cited FHA requirements that lead to a more cumbersome and expensive origination process. To better understand these processing issues, lenders were asked to estimate processing time and the incremental costs associated with an FHA mortgage when compared to the average processing times for conventional-conforming and subprime loans. Lenders were also asked to rank the various steps in the FHA origination process on a scale of one to five, based on their estimated impact on origination costs.

Processing Costs

As shown in Figure 6, the overwhelming majority of lenders believed that FHA loans were more costly to originate than other types of mortgages. However, the degree of cost differential was notably different among survey respondents. The majority of respondents reported that FHA loans were "one to 25 percent higher" or "25 to 50 percent higher." Only 9 percent of survey respondents believed that FHA loans were no more costly to originate compared to other product types.

FIGURE 6: COST OF ORIGINATING FHA LOANS RELATIVE TO OTHER LOAN TYPES (% RESPONDING)



More than 90 percent of respondents also reported that training costs were higher for FHA lending. Again, there was considerable variation in the estimated size of the cost differential. When compared to other product offerings, 46 percent reported that FHA lending increased annual training costs between "one and 25 percent", while 35 percent estimated incremental costs to be between "25 and 50 percent". The remaining 9 percent felt that FHA lending increased annual training costs by more than 50 percent.

Processing Time

Higher origination costs associated with FHA mortgages are consistent with lenders' estimates of the average number of days required to process, approve and originate various types of loans, i.e., time from initial application to final approval, from final approval to closing, and from closing to investor delivery (i.e., sale of the loan to a wholesaler or the secondary market).

As shown in Table 3, the average time it takes to process an FHA mortgage was estimated to be approximately 13 days longer than for prime conventional product. Most of the time difference was reported to occur in the initial application and approval stage, where FHA mortgages are reported to take an average of nine days longer to process than the typical conventional prime mortgage. While processing times for subprime loans are also reported to be somewhat shorter, the differences are small and primarily occur in the investor delivery stage.

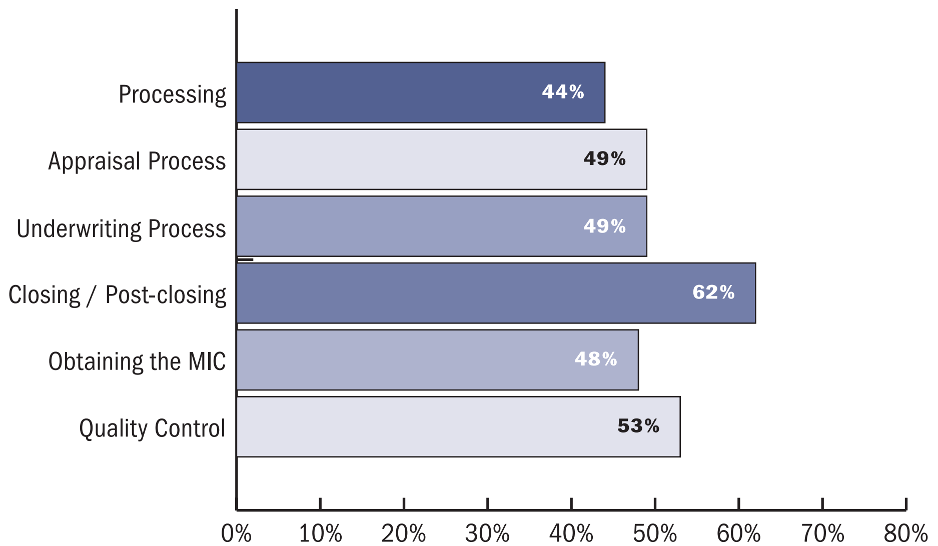
TABLE 3: AVERAGE PROCESSING TIMES BY PRODUCT TYPE

	FHA Loans	Conventional	
		Prime	Subprime
Application to Final Approval	22 days	13 days	21 days
Final Approval to Closing	13 days	12 days	13 days
Closing to Investor Delivery	14 days	11 days	11 days

Processing Inefficiencies

Lenders were also asked to rank, on a scale of one to five, the specific stages of the processing cycle according to their contribution to origination costs (Figure 7). In general, the complexities involved in origination were seen as pervasive, affecting every phase of the origination process beginning with loan approval and extending through closing and funding.

FIGURE 7: PERCENTAGE OF LENDERS IDENTIFYING EACH AS A "SIGNIFICANT" OR "MAJOR" CONTRIBUTOR TO HIGHER FHA ORIGINATION COSTS



Loan Processing

Forty-four percent of lenders surveyed indicated that loan processing significantly increased the costs of originating FHA loans. “Processing” begins with the initial receipt of a loan application, and includes the various steps involved in creating a loan file and ensuring that it contains all the documentation required for underwriting, such as the applicant’s pay stubs, bank records and credit report. Processors are also frequently tasked with ordering appraisals, flood certifications, and title and closing (or escrow) services.

Processing is a labor-intensive effort in conventional as well as FHA lending. However, lenders pointed to certain requirements that add to the complexity of FHA loans, for example the need to obtain an FHA case number from HUD and a clearance code from HUD’s Credit Alert Voice Response System (CAIVRS). (CAIVRS identifies consumers who have previously defaulted on a federally assisted loan.) FHA processors are also required to generate a number of disclosures to borrowers that are not required by conventional loans.

The Appraisal Process

Forty-nine percent of the lenders surveyed viewed the appraisal process as a “significant” or “major” contributor to the higher costs of FHA loans. Like processing, appraisals must be completed prior to the final approval of the loan. Most appraisals, whether conventional or FHA, employ a market-based approach in which the value of the subject property is estimated based on recent sales of similar units (“comparables”) in nearby areas. However, FHA also requires appraisers to complete a more comprehensive review of the property’s condition using form HUD-92564-VC, commonly known as the “VC Sheet.” The form has since been retired pursuant to Mortgagee Letter 2005-34. Subsequent participant discussion revealed that these recent FHA initiatives represent positive progress towards improving the process in the minds of lenders. The VC Sheet not only involves a meticulously detailed assessment of the property, it also requires that the seller remedy a series of deficiencies that would not be considered in a conventional appraisal. Some of the required inspection items include:

- Site hazards and nuisances
- Soil contamination
- Grading and drainage
- Well, individual water supply, drainage
- Wood-destroying insects
- Private road access and maintenance
- Structural conditions
- Foundation
- Roofing

- Mechanical Systems
- Other health and safety deficiencies
- Lead-based paint hazard

In addition to the VC Sheet, FHA formerly required lenders to complete a separate Notice To Homebuyer (HUD-92564-HS) that had to be delivered at a certain time. This requirement, which was previously problematic to originators, has been substituted with the ability of a lender to deliver the appraisal to the homebuyer, as is common in the conventional market.

These additional requirements made the FHA appraisal process substantially more cumbersome than the conventional mortgage appraisal process. In fact, the complexity of the appraisal process, which has been revised,[8] undoubtedly explains why 78 percent of the lenders surveyed believed that real estate agents view bids with FHA financing as inherently weak.

Underwriting Process

Forty-nine percent of the lenders surveyed also viewed the underwriting process as a significant factor to higher origination costs for FHA mortgages. Mortgage underwriting refers to the process of evaluating an applicant's ability and willingness to repay the loan, which is typically based on the property value as well as the income, liabilities, and credit history of the borrower. In the past, underwriters of all product types followed a detailed set of guidelines designed to distinguish between "acceptable" and "unacceptable" levels of risk. However, the introduction of automated underwriting in the late 1990s greatly simplified this process, and reduced the time it takes to approve a loan from several weeks to several hours. Automated underwriting tools are now widely accepted among lenders and investors. In fact, underwriting for conventional lending only requires a manual process in cases where an automated approval cannot be obtained (for example, when the applicant has little established credit).

However, FHA loans continue to require the review of an FHA-approved direct endorsement underwriter, even in cases where the loan has been approved by an automated underwriting system. FHA underwriting also requires the completion of a "Mortgage Credit Analysis Worksheet" (MCAW), which is frequently cited by lenders as one of the more cumbersome requirements of the origination process. Responding lenders noted that the primary reason they dislike the MCAW is the complicated "settlement requirements" calculation that determines whether the borrower is meeting the 3 percent down payment requirement. These requirements likely contribute to the longer time to close an FHA loan which, in turn contributes to higher cost to originate.

8 These revisions, pursuant to Mortgagee Letters 2005-34 and 2005-48, took effect on January 1, 2006. The announcements were released during the survey period.

Closing/Post-Closing

The highest percentage of respondents — 62 percent — identified the closing/post-closing process as a "significant" or "major" contributor to the higher origination costs of FHA loans. While "closing" and "post-closing" are separate processes, they are often considered in tandem because the processes are closely associated. Once a loan has been approved, the file is sent to the closing department where final loan documents are drawn and the file is prepared for settlement. After settlement, the signed documents are returned to the lender for a "post-closing" review to ensure that the file is complete, accurate, and properly signed.

The conventional post-closing process is a fairly cursory review to ensure that the requisite documents are in place and that the mortgage note and security instrument are properly signed. In contrast, the FHA process previously involved a more intensive review of the file to ensure that the loan will be approved for FHA insurance. Subsequent to FHA's recently announced Mortgagee Letter 2005-36 which establishes a new "Lender Insurance Program (LI)",[9] FHA guidelines stipulated a long list of minimum post-closing review standards, including reviewing and/or verifying that:

- The loan is current (if more than 60 days after closing);
- The note and mortgage/security instrument are complete, accurate, and consist with the program;
- The MCAW is complete and calculated accurately;
- The appraisal and VC sheets are complete;
- Various disclosures and forms unique to FHA lending are present, and
- No mortgage insurance premium (MIP), late charge or interest is due.

Lenders report that these and other additional review requirements make the post-closing process substantially more time consuming and costly for FHA loans than for conventional loans.

Under the new FHA LI program, lenders with acceptable default and claim rates are permitted to endorse their own FHA loans without a pre-endorsement review conducted by FHA. The need to submit case binders to FHA is also limited to a sample of mortgages selected by HUD for a "post-endorsement technical review." Within several weeks of the issuance of Mortgagee Letter 2005-36, 61 percent of respondents indicated they would participate in the program and 87 percent of lenders planning to participate expected to see a decline in their average cost of originating FHA loans.

9 Mortgagee Letter 2005-36 which establishes a new "Lender Insurance Program" went into effect on January 1, 2006.

Obtaining the Mortgage Insurance Certificate (MIC)

Forty-eight percent of the lenders surveyed also reported that obtaining the Mortgage Insurance Certificate (MIC) had a significant impact on processing costs. The MIC serves as evidence to the lender and subsequent investor that the loan has been insured by the government. FHA has recently taken steps to improve the process of obtaining the MIC, most notably by moving to a paperless system. HUD issues a Notice of Return (NOR) whenever it discovers a deficiency in a loan file submitted for insurance. Lenders receiving a NOR has a 60-day window to resolve the deficiency; after which the loan is required to be current for FHA insurance eligiblity. An inability to secure FHA insurance significantly impairs the price a lender can command for the loan on the secondary market.

Quality Control

Finally, 53 percent of all lenders reported that quality control procedures led to significant or major increases in processing costs. Most lenders, whether they originate FHA-insured loans or not, are required to have a quality control program. These programs vary by lender, but share a number of characteristics. The most common feature found in any quality control program is the requirement to conduct a thorough audit of 10 percent of all loans originated within a given month or quarter. These audits generally must be completed within a stipulated period of time, e.g., within 90 days of settlement.

FHA guidelines prescribe a substantial list of requirements that approved FHA lenders must incorporate into their quality control plans. The specificity of these requirements, combined with the relative complexity of an FHA loan file, significantly adds to the time and expense of carrying out appropriate quality control on FHA mortgages.

Securitization

In contrast to the general dissatisfaction surrounding FHA's approval and closing processes, there was far less agreement around the role of Ginnie Mae. For example, while 32 percent of all respondents agreed with the statement "Ginnie Mae meets our needs," the majority (56 percent) had no opinion and a small minority (13 percent) disagreed. Lenders were equally mixed when asked if they agreed with the statement: "FHA loans do not present any secondary marketing challenges." These relatively mixed assessments stand in stark contrast to lenders' generally unfavorable assessment of FHA, and suggest that most of the drivers of higher costs are concentrated in the front-end of the process, with only minimal friction created by the back-end securitization.

Recent HUD Initiatives

FHA recently announced two significant program enhancements that are expected to address several of the processing issues identified by survey respondents.

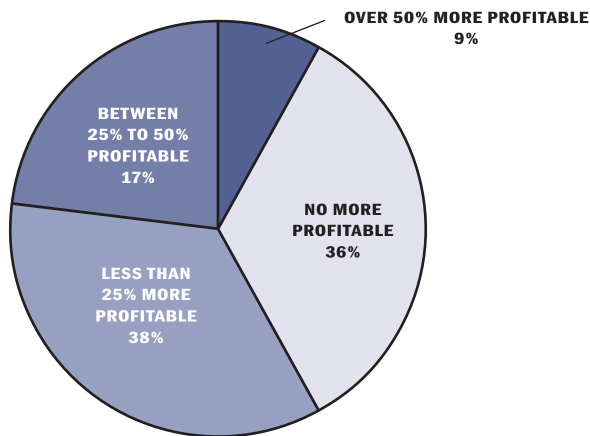
The first announced in Mortgagee Letter 2005-34, updated FHA's appraisal protocol. Under the new protocol, which went into effect on January 1, 2006, the "VC Sheets" and "Notice to Homebuyer" will be retired and lenders will be permitted to solely use the industry-standard Uniform Residential Appraisal Report (Fannie Mae Form 1004) to fulfill the FHA appraisal requirement. A majority (54 percent) of survey participants reacted favorably to this announcement, believing that it would lower origination costs and reduce resistance to FHA financing.

The second enhancement, announced in Mortgagee Letter 2005-36 establishes a new "Lender Insurance Program," which also went into effect on January 1, 2006. Under the LI program, lenders with acceptable default and claim rates are permitted to endorse their own FHA loans without a pre-endorsement review conducted by FHA. The need to submit case binders to FHA will also be limited to a sample of mortgages selected by HUD for a "post-endorsement technical review." Although the survey was released only within a couple of weeks of the issuance of Mortgagee Letter 2005-36, 61 percent of respondents indicated they would participate in the program. Eighty-seven percent of lenders planning to participate expected to see a decline in their average cost of originating FHA loans.

Risk versus Profitability

A key issue likely to limit FHA's ability to recover market share is that most lenders reported that they were not being adequately compensated for the higher risks associated with FHA lending. These risks include credit risk, reputation risk, and indemnification risk. With these risks, a large number of respondents reported that FHA lending was no more profitable than other types of lending. As shown in Figure 8, 64 percent of survey respondents reported that FHA was more profitable than other lending, with 38 percent estimating that the difference was between "one and 25 percent". However, 36 percent of the lenders reported that FHA loans were "no more profitable" than other products, and when asked if they felt adequately compensated for the higher delinquency rates and risks involved in originating and servicing FHA loans, over half of all survey respondents answered no.

FIGURE 8: PROFITABILITY OF FHA LOANS RELATIVE TO OTHER LOAN TYPES (% RESPONDING)



Lenders who perceived a profitability advantage of FHA lending consistently reported servicing assets as the primary driver. FHA loans are most often securitized into Ginnie Mae securities, which can carry a servicing fee as much as 44 basis points (bps).[10] This compares to an average of 25 bps for servicing loans sold to Fannie Mae or Freddie Mac.[11] Higher servicing valuations due to higher servicing fees was cited as a significant or major contributing factor to higher profitability by 46 percent of lenders surveyed, while an additional 24 percent cited higher servicing fees as a moderately important driver (see Table 4). Only 30 percent of respondents reported that higher servicing fees were a minor factor or not a factor at all.

TABLE 4: FHA PROFITABILITY DRIVERS

Percentage of Lenders reporting each characteristic as a:

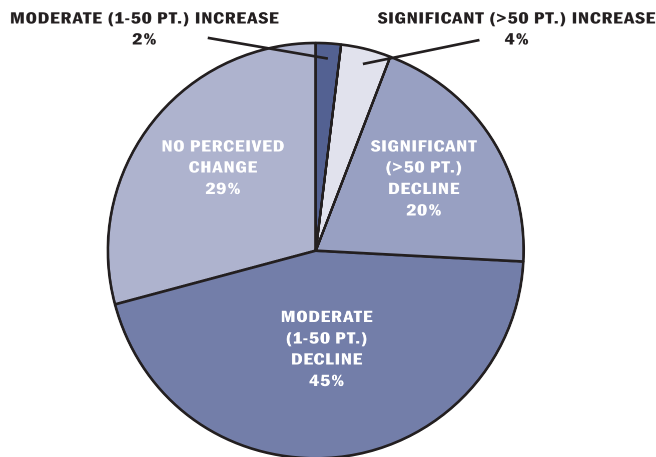
	Higher Servicing Fees	Slower Prepayments	Premiums for Affordable Housing
Major Profitability Factor	46%	38%	28%
Moderate Profitability Factor	24%	29%	32%
Minor Profitability Factor/ Not a Factor	30%	33%	40%

In a similar vein, 38 percent of participants identified better servicing valuations from slower prepayment speeds as a significant or major factor, while one-third of respondents reported this as a minor factor or not a factor at all. Although participants generally agreed

10 While Ginnie Mae I securities require servicing fees of 44 basis points, Ginnie Mae II securities allow servicing fees as low as 19 basis points.

11 The President's 2007 budget proposes an upfront administrative fee of 6 bps on Ginnie Mae securities that is expected to further increase costs.

FIGURE 9: PERCEIVED CHANGE IN FICO SCORE OF AVERAGE FHA BORROWER RELATIVE TO PREVIOUS YEARS (% RESPONDING)



that slower prepayments contributed to the profitability of FHA lending, only 18 percent believed that that slower prepayment speeds were adequate compensation for higher delinquency rates.

Although considered a less significant factor by the participant group, the willingness of investors to pay premiums for CRA-related housing loans[12] was also noted as a driver of FHA profitability. Twenty-eight percent of lenders reported that premiums received from affordable housing loan sales was a significant or major factor to FHA profitability. On the other hand, 40 percent reported that affordability housing premiums were only a minor factor or not a factor at all in FHA profitability.

Issues of risk also factor into a lender's decision whether to promote FHA loans. The study collected lender views on three distinct types of risk: credit risk, reputation (business) risk, and indemnification risk.

Credit Risk

Several participating lenders reported that they have begun to view FHA programs as "products of last resort." Respondents noted that higher-credit-quality loans that would otherwise be originated as FHA products are instead being originated as Alt-A or Agency-Eligible, often under expanded-approval guidelines, leaving the more severely credit challenged to FHA.

12 Commercial banks and thrift institutions actively seek out loans made to lower-income households in order to meet targets established by the Community Reinvestment Act of 1977 (CRA).

> "The higher quality loans have been siphoned off to lower margin programs. The deterioration in loan quality has increased costs and increased the risk of repurchases due to early payment defaults as well as indemnification risk." *—A Small FHA Lender*

As a result, 65 percent of respondents believed that the credit quality of a "typical" FHA borrower has declined in recent previous years (see Figure 9). Roughly 20 percent of respondents saw the decline as "significant"— more than a 50 point drop in the average FICO score — with 45 percent reporting a more moderate decline. The reported declines in FICO scores are consistent with the data presented in Figure 2, which show marked declines in the relative performance of FHA loans.

Participants reported feeling the effects of this decline in credit quality in both their origination activities and their servicing portfolios. Higher delinquency rates almost always translate into higher servicing costs. Further, lenders believed that higher delinquency rates substantially increased the likelihood that they would be called before HUD's Mortgagee Review Board, which oversees the performance of lenders to ensure compliance with FHA/HUD requirements. The Board has the authority to impose sanctions ranging from reprimands and civil money penalties to withdrawal of approval, effectively terminating a lender's ability to originate FHA loans. Lenders reported disliking that they may be held accountable for all loans that go delinquent within 24 months, including loans that manifested only minimal risk at the time of origination.

Reputation (Business) Risk

Participants were asked to rate the incremental business risk associated with FHA lending in three distinct areas, all of which contribute to reputation risk:

- Risk of not being able to fulfill commitments of FHA loans to borrowers
- Risk of higher delinquency rates
- Negative publicity

Participants overwhelmingly cited the higher delinquency rates associated with FHA lending as the most significant source of business risk, with nearly three out of four lenders considering it at least a moderate risk (see Table 5). This stands in contrast to the risk of being unable to fulfill FHA loan commitments made to borrowers (as a result of property deficiencies, for example). More than two-thirds of participants considered this to be of "minimal" or no risk. Likewise, negative publicity due to other factors was also cited as a moderate or minimal risk by most respondents.

TABLE 5: REPUTATION/BUSINESS RISK MATRIX

	Commitment Risk	Higher Delinquency Rates	Negatively Publicity
Percentage of Lenders classifying each as a:			
Maximum/Significant Risk	4%	33%	24%
Moderate Risk	27%	39%	32%
Minimal/No Risk	69%	28%	44%

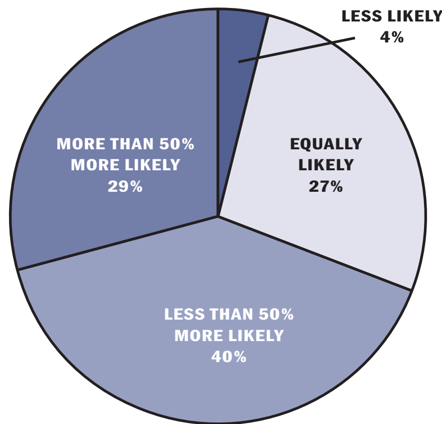
Indemnification Risk

Indemnification risk is the risk that HUD will require a lender to "indemnify" the department against any insurance losses incurred as a result of loan default. While HUD conducts cursory reviews on all loans submitted for FHA insurance, it conducts more in-depth "post-endorsement technical reviews" (PETRs) on 10 percent of submissions. HUD can require indemnification in cases where a PETR reveals that an insured loan file was not originated in compliance with FHA guidelines. Further, as previously noted, lenders reported a concern with HUD's Mortgagee Review Board, which oversees the performance of lenders to ensure compliance with FHA/HUD requirements. In addition, HUD Inspector General (IG) audits represent an additional layer of FHA lender oversight beyond the typical oversight conducted by FHA's quality assurance division. Although previously focused on fraud related concerns, HUD-IG audits seemed to be focused increasingly on compliance issues.

The risk of indemnification is analogous to representation and warrant risk incurred when selling loans to Agency or private investors. When compared to private loan sales or loans sales to the Agencies, pre-survey interviews revealed that HUD indemnifications result from comparatively minor documentation deficiencies that are not necessarily related to a borrower's ability or willingness to repay. Respondents also noted that HUD is often too quick to require indemnification in the event of default. These issues have a direct impact on the willingness of lenders to promote or offer FHA products. Among survey participants, 69 percent felt they were more likely to have to indemnify an FHA loan than to repurchase a non-FHA loan (see Figure 10).

"The change in credit quality has created double and triple the risk when originating FHA loans. FHA has hamstrung lenders by pushing us to originate higher risk FHA loans while still holding us responsible for loans that go into default within the first 24 months, even if the loans had little risk at the time the loan was originated... For this reason, we have shied away from FHA to pursue other, less risky avenues..."
—A Small FHA Lender

FIGURE 10: LIKELIHOOD OF INDEMNIFYING FHA LOANS RELATIVE TO REPURCHASING NON-FHA LOANS (% RESPONDING)



These results are buttressed by a similar perception regarding an increase in FHA indemnification rates. More than half (58 percent) reported that indemnification rates have increased over the past five years, compared with just 6 percent who feel that indemnification rates have decreased.

It is not surprising that a majority of survey respondents reported that the risk of indemnification was a significant consideration when evaluating FHA program offerings. Sixty-four percent of participants agree or strongly agree that indemnification risk is a consideration in their company's decision to promote FHA products. This suggests that lenders view FHA loans not only as more costly to originate, but as having the potential to generate even higher portfolio costs as a result of adverse insurer actions.

Summary and Implications

While lenders differed in their specific assessments of FHA, several broad themes emerge from the survey. To begin with, the great majority of lenders see FHA's loss in market share as two-fold: while respondents viewed the shift to Agency products as a long-term phenomenon, the shift to the subprime market and "alternative" products (for example, Option ARMs), was viewed as a cyclical event that could diminish when credit spreads widen. This indicates that FHA program changes could lead, at least partially, to a corresponding increase in FHA origination.

Given this perspective, it is not surprising that the majority of lenders surveyed viewed FHA's lack of a zero-down payment product as the most significant weakness in its existing product line. While FHA was once the dominant player in the low-down payment market, both the Agencies' movement into higher LTV products (combined with their expanded credit guidelines) and private sector high LTV products, were seen as major drivers of FHA's declining market share. In contrast, lenders were more mixed in their assessments of the potential impact of product innovations outside the agency market, for example, payment options mortgages.

In addition to weaknesses in product line, the majority of lenders reported that origination costs were significantly higher for FHA loans, and that higher costs had at least a "moderate" impact on their willingness to promote specific products. While every phase of the origination process was viewed as contributing to these higher costs, lenders' estimates of processing times suggest that the greatest problems occur in the approval stage, and that most of

these differences relate to Agency loans. Differences in the processing times and, presumably, the origination costs of FHA versus subprime loans were believed to be small. Again, this result suggests that improvement in FHA programs could lead to a partial increase in FHA originations.

In addition to reporting the higher costs of originating FHA loans, most lenders reported that they were not being adequately compensated for the higher risks associated with FHA lending. In fact, most lenders believed that their indemnification risk was growing with the deterioration of their FHA book, and was now significantly higher than the repurchase risk associated with Agency loans. While the majority of lenders believed that FHA overall remains more profitable than other lending, this greater profitability was primarily seen as being driven by higher servicing fees and slower prepayments. Premiums for "affordable" loans were also viewed as contributing to profitability.

HUD's recently announced Lender Insurance program and new appraisal protocols are expected to address many of the processing issues identified by survey respondents. For the most part, lenders viewed these initiatives as a positive step. Many important issues, however, remain unresolved including the need to produce more competitive product offerings, as well as the need to mitigate the substantial risks that lenders face in originating FHA loans. However, the future remains hopeful. The survey suggested a consistent interest in FHA lending and revealed numerous opportunities to improve FHA program offerings and restore FHA's valuable contribution in promoting homeownership among low- and moderate-income families.

> "I have been doing FHA loans since 1969... I have always found the FHA staff... to be very helpful. I believe in the FHA loan program. It takes my staff longer to process a FHA loan, but I can still get a FHA done in the same amount of time as a conventional loan, I just have to have more staff... Zero-down payment and reduction of disclosures would go a long way in FHA's regaining their market place. I do think they will make it. I certainly hope so." *—A Top 100 FHA Lender*

Appendix

INTRODUCTORY QUESTIONS

No. of Responses	Please indicate your level of agreement with the following statements:	Strongly Agree (1)	Agree (2)	Neither Agree Nor Disagree (3)	Disagree (4)	Strongly Disagree (5)
59	The existing suite of FHA products meets market demand.	0 0%	11 19%	8 14%	29 49%	11 19%
57	Slower prepayment speeds adequately compensate for higher delinquency rates among FHA loans.	0 0	10 18	27 47	17 30	3 5
59	We are adequately compensated for the higher costs and risks associated with being an FHA lender.	2 3	14 24	13 22	23 39	7 12
58	FHA loans do not present any secondary marketing challenges.	3 5	20 34	13 22	18 31	4 7
57	Ginnie Mae meets our needs.	1 2	17 30	32 56	6 11	1 2
55	Real estate agents view bids with FHA financing as inherently weak.	14 25	29 53	11 20	1 2	0 0
58	Indemnification risk is a consideration in our company's decision to promote FHA products	16 28	21 36	13 22	7 12	1 2
58	The availability and functionality of technology designed to support FHA lending is about as good as what's available for other loan products	1 2	19 33	11 19	23 40	4 7
57	The subprime market is gaining at the expense of FHA due to the overall compressed level of credit spreads.	15 26	30 53	8 14	4 7	0 0
58	Demand for FHA loans will pick up if credit spreads increase markedly.	1 2	16 28	18 31	21 36	2 3
58	The decline in FHA market share is a merely a short-term phenomenon.	3 5	0 0	3 5	32 55	20 34

LOAN SOURCING

No. of Responses	To what extent do each of the following contribute to the likelihood that FHA loans will be promoted by your institution?	Not a Contributing Factor (1)	A Minor Factor (2)	A Moderately Important Factor (3)	A Significant Factor (4)	A Major Factor (5)
57	Geography	18 32	7 12	18 32	9 16	5 9
57	Loan Officer tenure (longer-tenured employees have more comfort with FHA lending)	18 19	11 32	14 19	3 25	5
58	Pricing (Loan Officers / Brokers promote whatever is likely to maximize commission)	10 31	11 17	14 19	5 24	9
17	Other	2 12	0 0	0 0	6 35	9 53

No. of Responses **To what extent do the following drivers influence your product offerings (FHA or other)?**

No. of Responses		Not a Factor (1)	A Mildly Important Factor (2)	A Moderately Important Factor (3)	A Very Important Factor (4)	A Critical Factor (5)
57	Desire to offer broadest possible product line	4 7	3 5	11 19	32 56	7 12
56	Drive volume	2 4	7 13	10 18	32 57	5 9
56	Alignment with existing risk profile	6 11	5 9	16 29	26 46	3 5
56	Cost (including incremental training costs)	5 9	9 16	19 34	18 32	5 9
57	Profitability	1 2	5 9	8 14	29 51	14 25

No. of Responses **Please rate the extent to which the following products, if they could be insured by FHA, would increase the number of FHA loans you originate?**

No. of Responses		No Increase (1)	A Mild Increase (2)	A Moderate Increase (3)	A Significant Increase (4)	A Major Increase (5)
57	100(+) LTV products	3 5	7 12	8 14	17 30	22 39
57	Interest-only/Option ARM products	8 14	15 26	15 26	14 25	5 9
57	Long-term (e.g., 40-year) fixed rate products	12 21	12 21	18 32	7 12	8 14
56	Stronger Cash-out refinance program	4 7	13 23	13 23	15 27	11 20
16	Other Products	4 25	1 6	2 13	5 31	4 25

No. of Responses **Within your organization, what percentage of FHA's 'lost market share' would you estimate is going to Agency high-LTV products and to subprime products?**

No. of Responses		
57	to Agency high-LTV products	62%
49	to Subprime	27%
20	to Other	11%

No. of Responses	To what extent do the following contribute to higher origination costs for FHA loans?	Not a Contributing Factor (1)	A Minor Factor (2)	A Moderately Important Factor (3)	A Significant Factor (4)	A Major Factor (5)
55	Underwriting Process	2 4	9 16	17 31	22 40	5 9
53	Appraisal Process	1 2	12 23	14 26	18 34	8 15
55	Processing	1 2	13 24	17 31	21 38	3 5
55	Closing/ Post-Closing	0 0	8 15	13 24	26 47	8 15
55	Quality Control	0 0	11 20	15 27	20 36	9 16
54	Obtaining the MIC	4 7	12 22	12 22	18 33	8 15
7	Other Processes	1 14	0 0	2 29	1 14	3 43

No. of Responses	To what extent do the following contribute to higher profitability of FHA lending?	Not a Contributing Factor (1)	A Minor Factor (2)	A Moderately Important Factor (3)	A Significant Factor (4)	A Major Factor (5)
53	Better execution due to banks' willingness to pay a premium for affordable housing loans	8 15	13 25	17 32	11 21	4 8
55	Better servicing valuations because of slower prepayment speeds	7 13	11 20	16 29	14 25	7 13
54	Better servicing valuations because of higher servicing fees	10 19	6 11	13 24	19 35	6 11
1	Other	1 100	0 0	0 0	0 0	0 0

No. of Responses	To what extent do the following contribute to higher profitability of FHA lending? (Including Only Responses from those who find it more profitable)	Not a Contributing Factor (1)	A Minor Factor (2)	A Moderately Important Factor (3)	A Significant Factor (4)	A Major Factor (5)
34	Better execution due to banks' willingness to pay a premium for affordable housing loans	5 15	6 18	10 29	9 26	4 12
36	Better servicing valuations because of slower prepayment speeds	3 8	4 11	12 33	11 31	6 17
35	Better servicing valuations because of higher servicing fees	5 14	0 0	9 26	16 46	5 14
1	Other	1 100	0 0	0 0	0 0	0 0

How much more costly would you estimate FHA loans are to originate (than non-FHA loans)?

Don't feel FHA lending is more costly	5	9%
1 – 25 percent more costly	22	41%
25 – 50 percent more costly	20	37%
50 – 75 percent more costly	6	11%
75 – 100 percent more costly	1	2%
More than 100 percent more costly	0	0%

How much higher would you estimate annual training costs are due to originating FHA-insured loans?

FHA Lending does not affect training costs	5	9
1 – 25 percent higher	25	46
25 – 50 percent higher	19	35
50 – 75 percent higher	4	7
75 – 100 percent higher	1	2
More than 100 percent higher	0	0

How much more profitable would you estimate FHA loans are to originate (than non-FHA loans)?

Don't feel FHA lending is more profitable	19	36
0 – 25 percent more profitable	20	38
25 – 50 percent more profitable	9	17
50 – 100 percent more profitable	5	9
More than 100 percent more profitable	0	0

Do you plan to participate in FHA's Lender Insurance Program (see Mortgagee Letter 2005-36) beginning in 2006?

Yes	28	61
No	18	39

If you plan to participate in the LI program, what percentage savings in the cost of originating FHA loans do you expect to experience?

0 percent savings	4	13
1 – 25 percent savings	26	87
25 – 50 percent savings	0	0
Over 50 percent savings	0	0

What percentage savings in the cost of originating FHA loans do you expect to experience as a result of the update to FHA's Appraisal Protocol (Mortgagee Letter 2005-34)?

0 percent savings	23	49
1 – 25 percent savings	24	51
25 – 50 percent savings	0	0
Over 50 percent savings	0	0

No. of Responses	Please estimate your average cycle time for each of the following (by product type).	
50	Days From Application to Final Approval – Conventional Loans	13 days
49	Days From Application to Final Approval – FHA Loans	22 days
37	Days From Application to Final Approval – Subprime Loans	21 days
50	Days From Application to Closing – Conventional Loans	24 days
49	Days From Application to Closing – FHA Loans	33 days
35	Days From Application to Closing – Subprime Loans	29 days
49	Days From Closing to Investor Delivery – Conventional Loans	11 days
48	Days From Closing to Investor Delivery – FHA Loans	14 days
35	Days From Closing to Investor Delivery – Subprime Loans	11 days
46	Final Approval to Closing – Conventional	12 days
44	Final Approval to Closing – FHA	13 days
30	Final Approval to Closing – Subprime	13 days

ISSUES OF RISK

No. of Responses **How would you rate the incremental business risk associated with FHA lending for the following:**

No. of Responses		No Risk (1)	Minimal Risk (2)	Moderate Risk (3)	Significant Risk (4)	Maximum Risk (5)
49	Risk of not being able to fulfill commitments on FHA loans to borrowers	13 27	21 43	13 27	2 4	0 0
51	Risk of higher FHA delinquency rates	4 8	10 20	20 39	14 27	3 6
50	Negative publicity associated with these/other factors	10 20	12 24	16 32	9 18	3 6
2	Other	0 0	0 0	0 0	0 0	2 100

In your experience, have indemnification rates in the past 5 years:

Increased	29	58%
Decreased	3	6%
Remained the Same	18	36%

How much more likely are you to have to indemnify FHA loans than to repurchase non-FHA loans?

Less likely	2	4%
No more or less likely	13	27%
1 – 25 percent more likely	11	22%
25 – 50 percent more likely	9	18%
50 – 100 percent more likely	6	12%
More than 100 percent more likely	8	16%

Dr. Ann B. Schnare

Dr. Ann B. Schnare is President of AB Schnare Associates, a consulting firm specializing in housing and mortgage finance, consumer credit, fair lending, public policy development and regulatory support. She also serves as Chair of the Center for Housing Policy. Prior to starting her own firm, Dr. Schnare was Senior Vice President for Corporate Relations and Vice President for Financial Research and Housing Economics at Freddie Mac. She has held a number of senior management positions in the consulting industry, including Director of the Center for Public Finance and Housing at the Urban Institute.

Bernadette Kogler

Bernadette Kogler is Managing Principal of Hollister Group a specialized consulting firm serving clients in the consumer finance and asset-backed marketplace. Prior to co-founding Hollister Group, Ms. Kogler spent ten years at KPMG Consulting providing strategic, operational and financial advisory services to some of the nations largest financial institutions. Ms. Kogler was responsible for managing cross-functional teams and delivering a combination of business and information technology solutions. Ms. Kogler was also a national resource to the Firm for cash flow analysis, valuation of prime and sub-prime mortgage portfolios and managing the associated risk. She also led the firm's performance studies regarding prime and sub-prime mortgage operations as well as studies for asset management. Prior to KPMG, Ms. Kogler worked for the Treasurer's Department of Prudential Insurance Company where she was responsible for counterparty risk management of the company's interest rate swap portfolio and evaluating capital requirements for the company's major business units.

Tim Willis

Tim Willis is Vice President of Hollister Group where he manages client engagements ranging from market research and benchmarking to business strategy and financial modeling. Prior to joining Hollister Group, he worked for Fannie Mae, where he was an instrumental member of a small team responsible for creating and analyzing business requirements for the development of a suite of systems designed to simplify asset creation and developing industry standards for paperless mortgages. He is also responsible for a large portion of the quantitative and statistical analysis behind Fannie Mae's 2001–2004 origination cost, profitability and productivity benchmarking studies. Prior to Fannie Mae, he was senior consultant at KPMG Consulting where he specialized in mortgage industry operational reviews, benchmarking engagements, discounted cash flow modeling, due diligence work, and compliance audits.

MORTGAGE BANKERS ASSOCIATION®

Investing in communities

1919 Pennsylvania Avenue, NW
Washington, DC 20006-3404
www.mortgagebankers.org
(800) 793-6222