Restoring Liquidity to Housing Finance

The Role of Prudent Low Down-Payment Lending

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Key Points

- Low down payment mortgages can be done safely with prudent, independent underwriting standards.

- Private mortgage insurance is a key component in assuring that low down payment mortgages are structured so that homebuyers get mortgages they can afford.

- Insured low down payment loans have a significantly lower risk of default.

- Sustainable low down payment mortgages are critical to the nation's economic and housing recovery: 40% of mortgages made in 2009 had a down payment of less than 20%.

Risk Retention and Mortgage Securitization

- Dodd-Frank creates a new risk retention requirement for securitizers.
  - All securitizers must retain at least a 5% interest in securitized assets, including residential mortgages.
  - Federally regulated securitizers like FHA and GNMA are provided a limited exemption from this obligation.

- A limited exception is provided for newly-established "qualified residential mortgages" (QRMs), subject to specific standards to be developed jointly by the financial regulators, the SEC, HUD and FHFA, consistent with TILA and CFPB regulations.

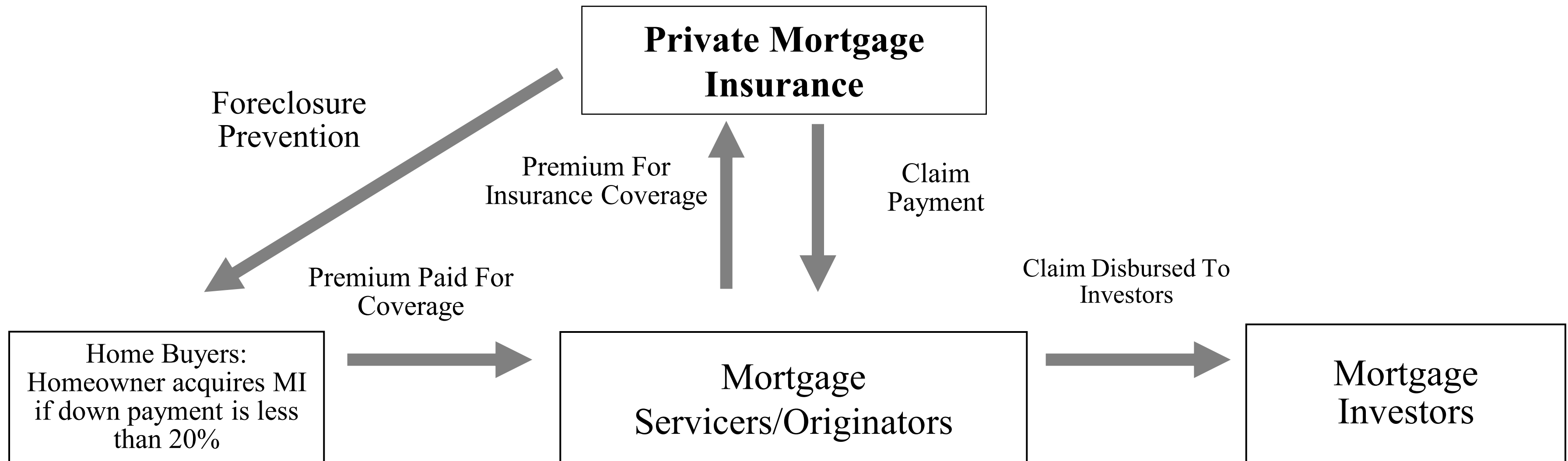
Qualified Residential Mortgages

- Dodd-Frank requires that the definition of QRMs should consider "underwriting and product features that historical loan performance data indicate result in a lower risk of default." The statute provides examples to be considered:
  - Documentation and verification of the financial resources of the borrower.
  - Amount of residual income after all monthly obligations.
  - Ratio of housing payments to monthly income.
  - Risk mitigation for ARMs through product features and underwriting standards.
  - Private mortgage insurance or other types of credit enhancement obtained at origination.

Prohibited Features for QRMs

- Balloon payments;
- Negative amortization;
- Prepayment penalties;
- Interest-only payments; and
- “Other features that have been demonstrated to exhibit a higher risk of borrower default.”

How Private Mortgage Insurance Works

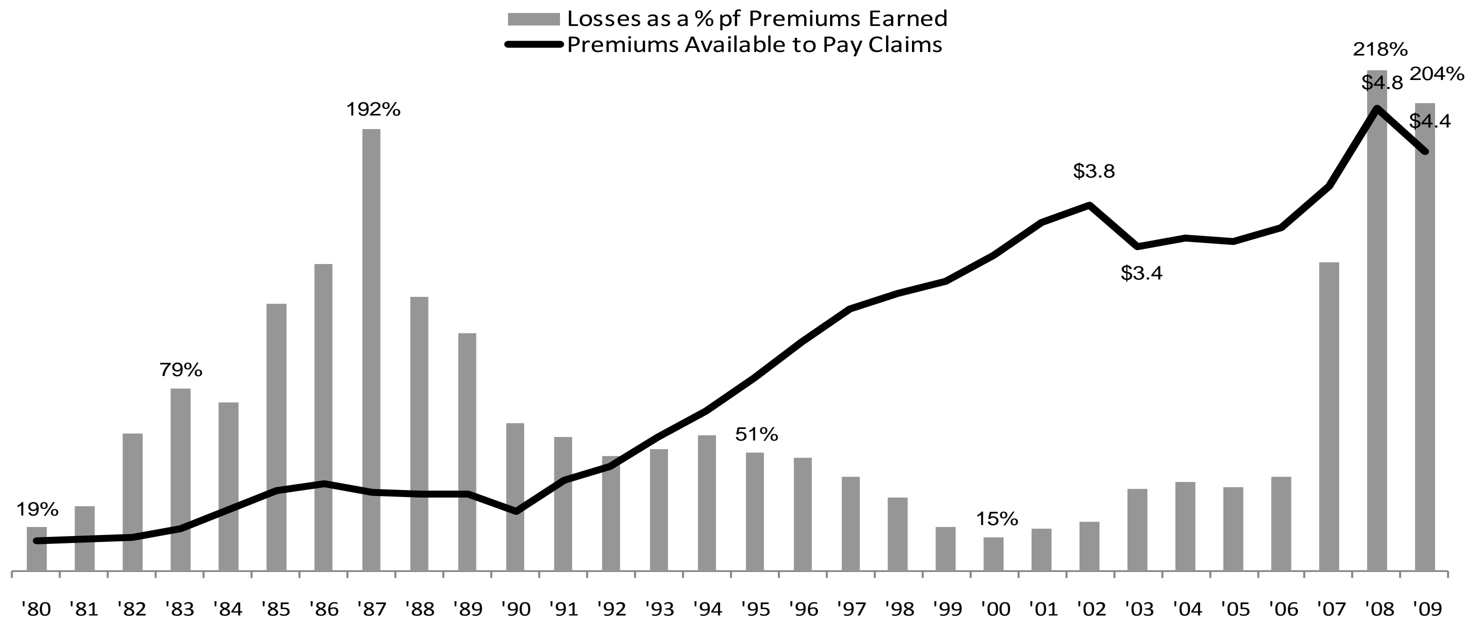


- Provides default risk discipline via independent underwriting criteria.
- Immediately commits private capital against each loan.
- Countercyclical model: Capital builds via state insurance regulatory requirement to hold 50% of all premiums received in a reserve fund, which is known as the contingency reserve.
- Pays in a "first loss" position in the event of borrower default.
- Interests of MI companies are directly aligned with borrowers and investors.
- Proactively works with borrower and servicer to prevent foreclosure.

The Value of Private Mortgage Insurance

- The private mortgage insurance (MI) model works exactly as designed.
- MIs build capital in good times by setting aside 50% of all earned premiums to pay claims in economic downturns.
- MIs have survived the worst housing finance crisis since the Great Depression.
- MIs have private capital available to support over 1.3 million new mortgages annually.
- Private mortgage insurance will play a critical role in the future of housing finance.

Private Mortgage Insurers Build Capital in Good Times to Pay Claims in Bad Times

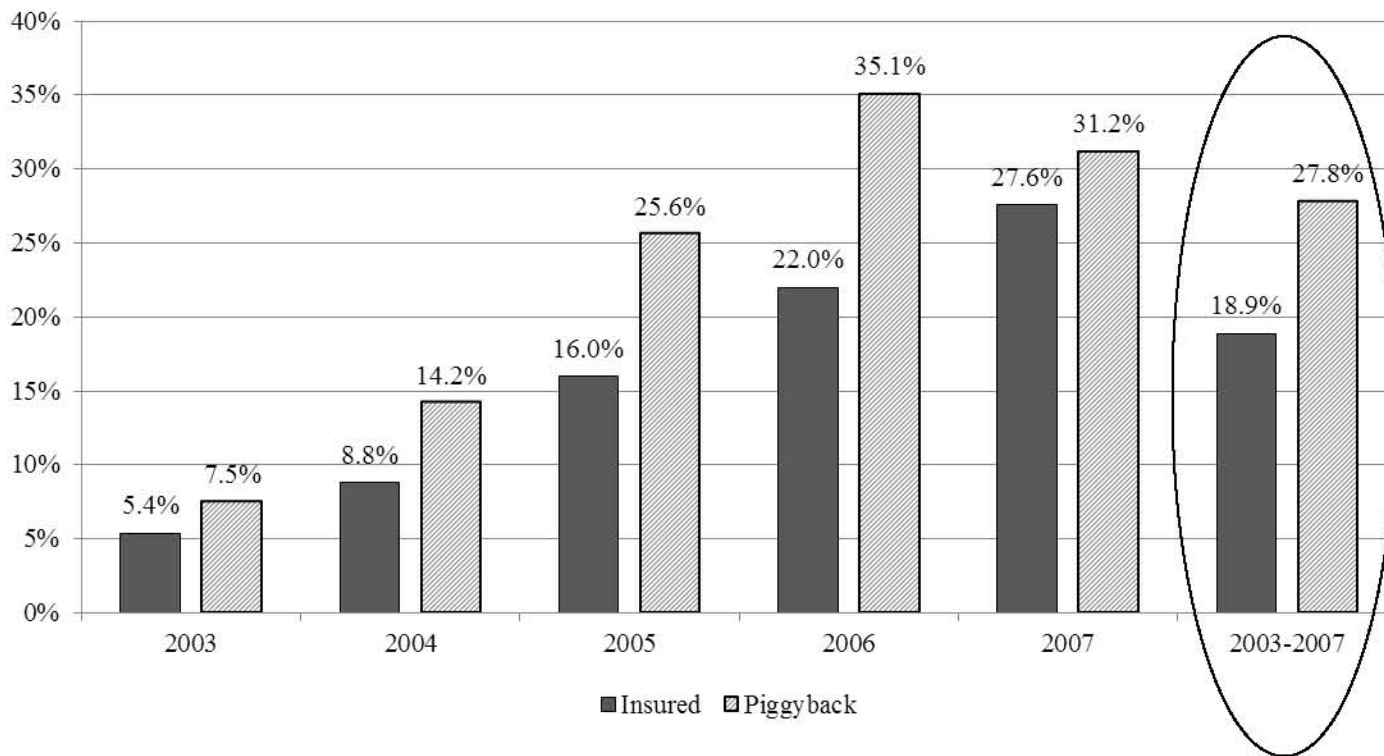


- Mortgage insurance is priced for long-term cycles.
- MIs build capital in good times by setting aside 50% of all earned premiums to pay claims in economic downturns.
- New business in a recovering economy rebuilds the companies' capital base and replenishes their contingency reserves.

*2009 includes new entrant capital (Essent Guarantee)

**Dollar amount of industry net risk on insured mortgages, divided by industry regulatory capital

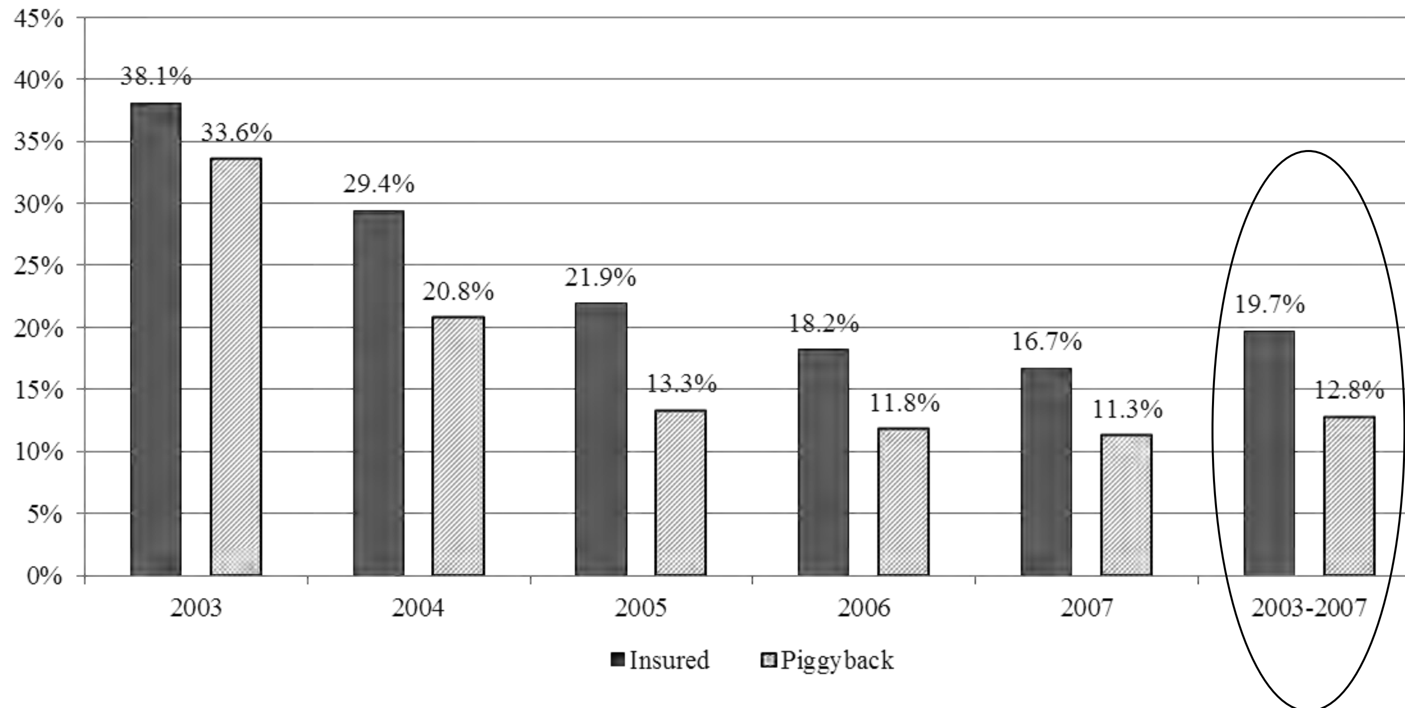
Piggyback Loans Became Delinquent 47% More Frequently than Insured Loans



Mortgage insurance dramatically reduces potential delinquencies.

Ever 90 Day Delinquency Rate: the number of loans that ever were delinquent for 90 or more days, divided by the original number of loans.

Insured Loans Cure 54% More Frequently than Piggyback Loans



Mortgage insurers have a vested interest in helping borrowers keep their homes and work closely with lenders, servicers and borrowers to cure delinquencies.

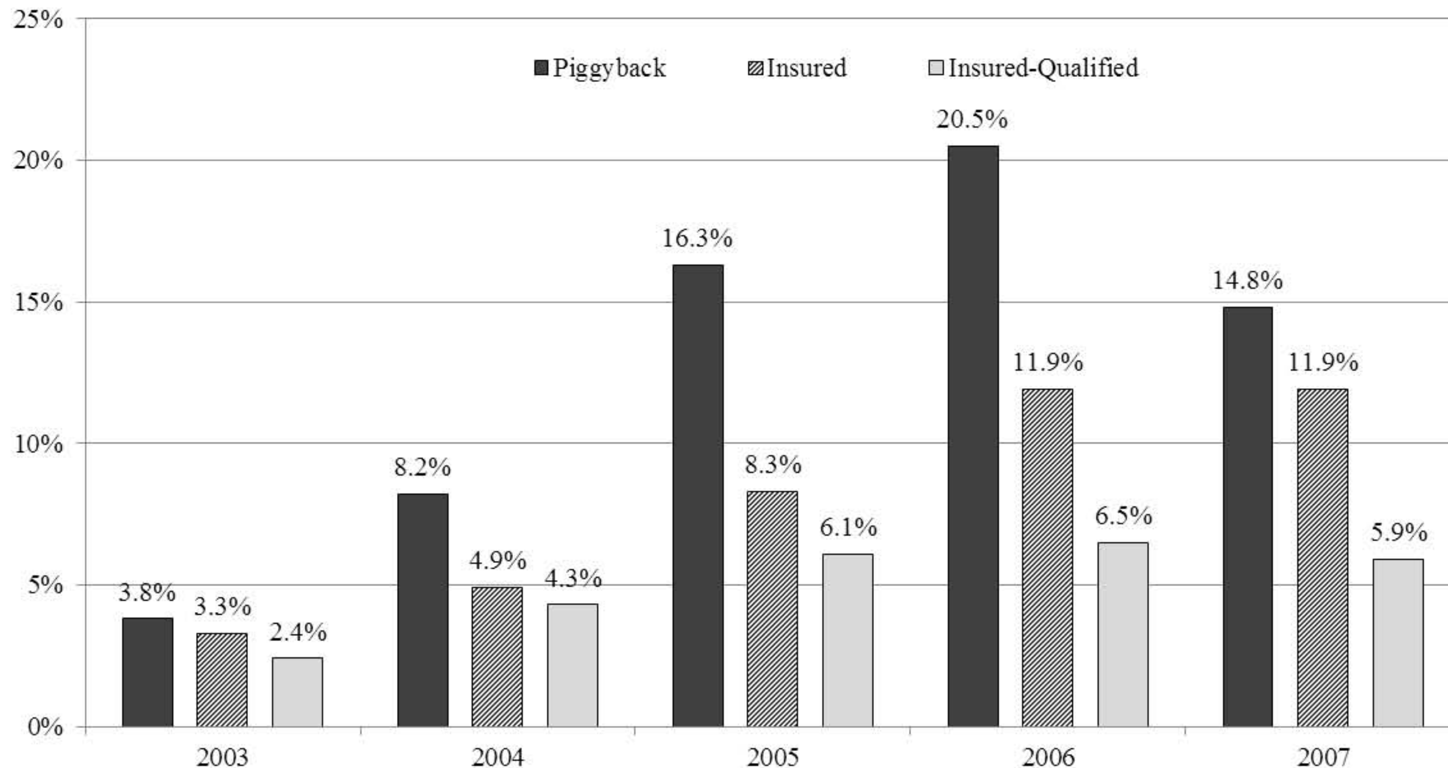
Cure Rate: the number of Ever 90 Day Delinquent loans that subsequently became current, divided by the total number Ever 90 Day delinquent loans.

Comparing Loans with QRM Features and Insured Loans

- For purposes of a performance study conducted by Vertical Capital Solutions*, the following underwriting standards were assumed:
    - Fully documented income and assets;
    - Total debt-to-income ratio of 41% or less;
    - Only fixed rate or 7/1 and greater adjustable mortgages;
    - Loans with a CLTV of greater than 80% must carry MI; and
    - Term equal to no more than 360 months.
- No balloon, interest only, or negative amortization mortgages.

* Using the CoreLogic Servicing Dataset.

Insured Loans with QRM Features Performed 65% Better in the Current Downturn

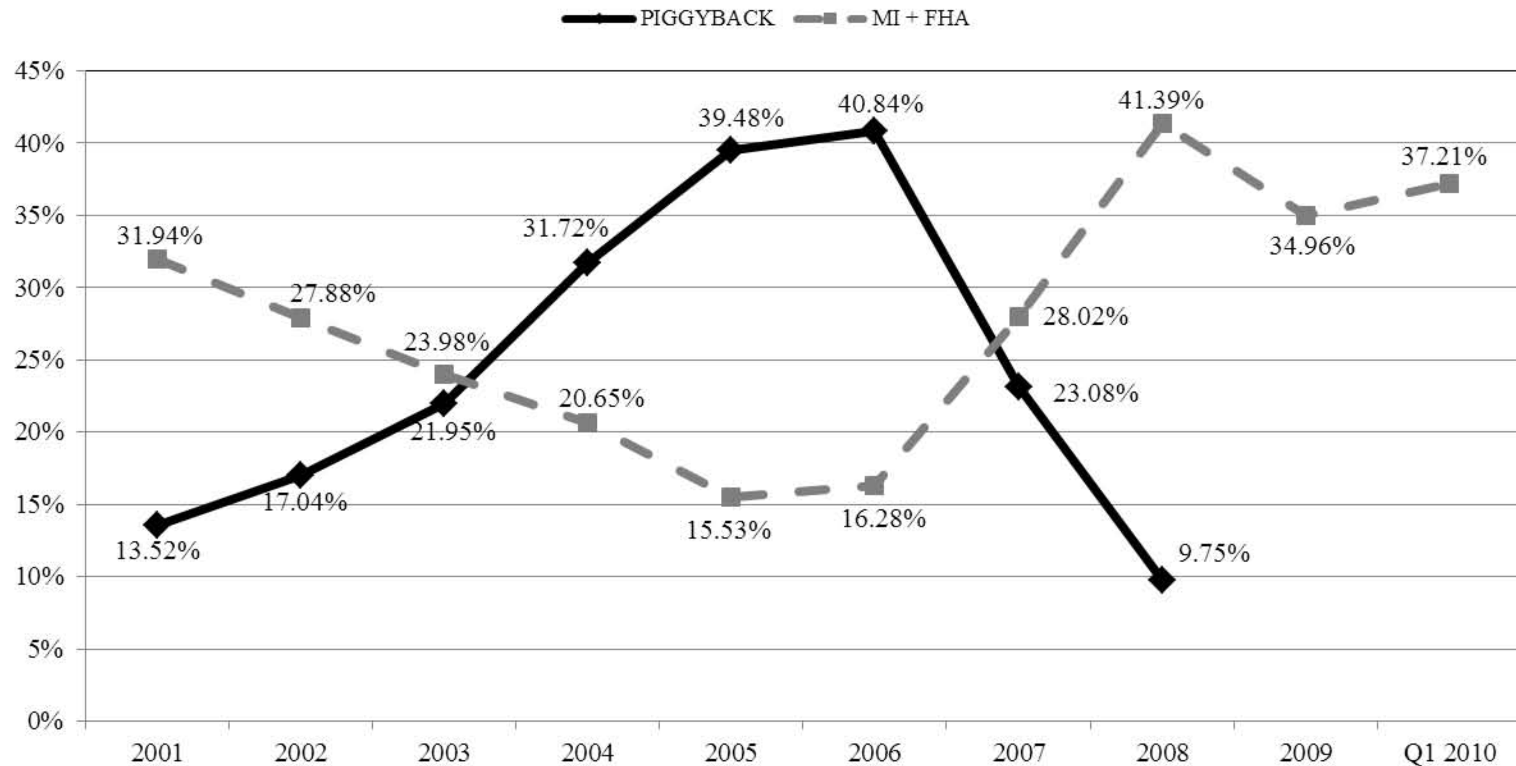


Non-Performing Rate: the number of loans currently 90 or more days delinquent plus the number loans that terminated in default, the total being divided by the original number of loans.

Sustainable Low Down Payment Mortgages Support the Market and Can Be Made Safely

- Prudently underwritten mortgages are sustainable over the long term.
- Private mortgage insurance plays a critical role in minimizing risks associated with low down payment mortgages.
- New QRM standards provide a guideline for safe low down payment lending.
- Sustainable low down payment mortgages are key to recovery in the housing finance market.

Piggyback Loans Compared to Insured Mortgage Loans



During boom years, piggyback loans exceeded combined FHA and MI loans.

Appendix

Key Terminology

- **Loan-to-value ratio (LTV)**: The amount of the loan compared to the price of the house. If the LTV is over 80%, it means that the borrower has made a down payment equivalent to 20% or less of the house price.
  - GSEs may purchase only those mortgages where the LTV is below 80%, or, if the LTV is above 80%, private mortgage insurance or another form of credit enhancement must be in place.

- **Insured Mortgages**: Mortgages that are insured by private mortgage insurers or by government insurers such as FHA or VA.

Piggyback Loans

- Prospective homebuyers whose down payment is too small to get the LTV to 80% and who choose not to get mortgage insurance may get a simultaneous second mortgage – known as a **“piggyback” loan** – at the time of the home purchase.
- The two mortgages create a **combined LTV (CLTV)**.
- These mortgages carry no insurance.