## The Mississippi Home Corporation Mortgage Guarantee Program

*The Problem*

For this component of the Mississippi Home Corporation proposal, there is a particular source of mortgage financing currently available to address some of the mortgage lending needs. However, these funds are being underutilized.

Specifically, FannieMae, in partnership with Mississippi Home Corporation, created the Mississippi "HomeRun" mortgage program in 1999 and allocated $50.0 million to this pilot. The purpose of "HomeRun" is serve as a low-downpayment, conventional mortgage product for Mississippi. The key handicap of the product is that the cost of FannieMae's requirement of 35% mortgage insurance coverage, as the payment-to-income ratio is too high for the low-to-moderate income borrowers targeted by the product. This requirement makes this product unaffordable. Consequently, only 10 loans totaling about $600,000, have been originated to date.

On the positive side, FannieMae has extended the duration of this program and has advised the Mississippi Home Corporation, should this program prove workable, FannieMae will continue allocating blocks of $50.0 million, as needed.

*The Mississippi FannieMae Partnership Office*

FannieMae has proved strongly committed to expanding lending in underserved markets across the country, and especially in rural areas, such as in the Mississippi counties within the Lower Mississippi Delta Region that is targeted by this initiative.

The Mississippi FannieMae Partnership Office will serve as a liaison and contact point to help Mississippi Home Corporation and its partners in this initiative gain access to FannieMae technical staff and resources that may be useful in expanding use of the HomeRun Mortgage in the counties targeted by the initiative.

Specifically, the Partnership Office will work in concert with research efforts under the proposal and with the Corporation's staff to help the non-profits become more effective in accessing bank financing

*The Process*

The Mississippi Home Corporation believes this pilot will be the enabler to help originate the "HomeRun" program. Again, this proposal has the support of other requisite parties in the state: The Mississippi Governor's Office and the Mississippi FannieMae Partnership Office.

Currently, the appropriate members of the Mississippi Home Corporation management team are:

- Communicating with the states that maintain such programs, the rating agencies and the private-sector mortgage insurers,

- Drafting the necessary documents, including the underwriting guidelines, for this program,

- Preparing its accounting systems to accommodate the processing and auditing of the insured loans and

- Determining the best marketing approaches to make this effort successful with the underserved, prospective homebuyers in the Mississippi counties within the Lower Mississippi Delta Region.

*The Proposal*

To augment its other efforts, and help the Mississippi Home Corporation increase the supply of safe, decent and affordable housing in the Lower Mississippi Delta Region, the Corporation proposes that:

- HUD join with the Mississippi Home Corporation in creating a self-insured, secondary mortgage insurance program, with an initial fund value of $1.0 million,

- That will leverage an additional $10.0 million in mortgages from a source of sustainable funds – FannieMae.

Additionally, with the experience, expertise and confidence to be gained from this (pilot) insurance program, the Mississippi Home Corporation will work to secure additional funds for the pool, such that Mississippi can grow to take full advantage of the FannieMae "HomeRun" money – which will be up to $50.0 million per year.

*Introduction to Private Mortgage Insurance*

Private mortgage insurance (PMI) is a policy written by a private company that protects the lender against financial loss by a borrower's default on a mortgage. Accordingly, housing finance authorities (HFA's) generally require that a mortgage insurance policy be purchased in an amount that brings the HFA's exposure level down to a set percentage, generally, 72 to 80 percent. In this case, the mortgage insurance policy makes the severity of the loss on a defaulted loan with a lesser downpayment similar to a loan with a 20 to 28 percent downpayment.

Mortgage insurance generally covers some portion of both the outstanding defaulted loan amount and the expenses necessary to gain title to and to sell the property, included legal expenses and real estate sales costs. In general terms, the loan guarantee or insurance is applied to against the total outstanding indebtedness of a defaulted loan and the associated expenses of foreclosure and interest accrued. After the liquidation of the property, any shortfall between the remaining total indebtedness and the coverage, is usually the loss the HFA must absorb.

The rating agencies view the protection that primary mortgage insurance provides as being a function of the insurance coverage level, the quality of the mortgage insurer and the terms of the insurance. Obviously, these factors vary by the type of insurance and guarantee in place.

There are a number of entities that provide such *primary coverage* to reduce the lender's risk exposure:

- The Federal housing Administration Insurance,
- The Veteran's Administration Guarantee,
- The Rural Housing and Community Development Service of the U.S. Department of Agriculture,
- Private Mortgage Insurance and
- State Mortgage Insurers.

Additionally, there are methods to lower the lender's risk through the use of *secondary insurance*, such as:

- Mortgage Pool Insurance and
- HFA Self-insurance Funds.

In the case of pool insurance, the insurance covers credit losses in a pool of mortgage loans, over and above any primary mortgage insurance that may exist on the individual loans. And with respect to self-insurance funds, the HFA's have pledged specific funds to cover that same aforementioned set of losses.

Pool mortgage insurance covers all of the losses on individual mortgage loans in the pool, so there is no individual mortgage loss limit as in the case with primary insurance. To illustrate, a pool of mortgage loans with a principal balance of $50.0 million may have a pool policy that covers losses up to $3.0 million, which in turn, establishes the provider's maximum exposure. Consequently, if the aggregate loss on the pool is $8.0 million, then the pool policy would be obligated to pay the $3.0 million, again, the provider's maximum exposure.

Additionally, some HFA's have pledged specific funds to cover losses associated with defaulted loans in their programs, and these funds are typically referred to as self-insurance funds. The rating agencies look to self-insurance funds to be sufficient to pay losses not covered by primary insurance policies under various "stressed" economic scenarios that are commensurate with the ratings on the bonds or the level of risk in the mortgage pool.

*Overview of State-Sponsored Mortgage Insurers*

State mortgage insurance funds have been in existence for over 20 years, and have been very successful in enabling *more production of* affordable housing, as the HFA's effectively created a market by insuring many loans that private mortgage insurance companies could not – or would not – insure. It was during this period that such states were considered the "insurer of the last resort", when such funds could only insure a loan after private mortgage insurers had declined to issue an insurance commitment.

By the end of 1999, on a combined basis, the seven states that use this credit tool have over $3.5 billion of gross risk in force, translating to $8.0 billion of mortgage loan principal.

And, these seven states, in keeping with their respective management strategies and social policies, are in the mortgage insurance business for two compelling reasons:

- Competition in the marketplace for both business and "balance of business" and

- Entry into this line is an innovative way to augment the stock of affordable single- and multi-family housing for prospective buyers who would not otherwise afford their monthly mortgage payment.

The Mississippi Home Corporation has embraced this second reason to enter the self-insured, secondary mortgage insurance business – to leverage (10:1 ratio in this pilot program) $10.0 million of FannieMae "Home Run" money. Thereby, augmenting the supply of safe, decent and affordable housing in the Mississippi counties within the Lower Mississippi Delta Region.

While the mortgage insurance programs described so far in this analysis expect the mortgage loan-to-value (LTV) ratio to be in the 80 to 97 percent coverage range, the "Home Run" product requires an LTV of 65 percent, otherwise, the terms of the "Home Run" program are excellent. Unfortunately, given the incomes of the target client base, when combined with FannieMae's required additional PMI coverage, the homebuyer's allowable level of PITI (principal, interest, taxes and insurance) has been exceeded, and the prospective homebuyer no longer qualifies for the loan.

Simply stated:

> *The difference between the cost of the mortgage insurance at the standard level compared to the incremental cost of the insurance at FannieMae's super level -- when combined with the homebuyer's remaining monthly obligations, the monthly note exceeds the underwriting provisions for the income-to-payment ratio.*

*Consequently, since "HomeRun's" inception in 1999, only 10 loans have been originated.*

Accordingly, to augment its other efforts, and help the Mississippi Home Corporation increase the supply of safe, decent and affordable housing in the Lower Mississippi Delta Region, the Corporation proposes that:

- HUD join with the Mississippi Home Corporation in creating a self-insured, secondary mortgage insurance program, with an initial fund value of $1.0 million,

- That will leverage an additional $10.0 million in mortgages from a source of sustainable funds – FannieMae.

Additionally, with the experience, expertise and confidence to be gained from this pilot insurance program, the Mississippi Home Corporation will work to secure additional funds for the pool, such that Mississippi can grow to take full advantage of the FannieMae "HomeRun" money, which can be up to $50.0 million per year.

*Assessing the Risk*

In terms of assessing a state's risk or worthiness to entertain such a venture, the rating agencies consider a number of qualitative and quantitative aspects of the proposal, with particular emphasis on the following areas:

1. *Capital Adequacy:*

   Capital adequacy is best measured by the insurer's overall loss potential to its equity base, plus any third-party support, such as reinsurance. To clarify, if an insurer has a risk-to-capital ratio of say 10:1, that means for every $10.00 of risk the fund has, the insurer has $1.00 to cover any loss on its insured loans. Clearly, assuming the risks are equal, the lower the first number in the ratio, the stronger the insurance fund is.

   Given that states typically maintain a more risky pool profile than do private-sector insurers – because, public pools tend to include a greater number of loans underwritten with more "flexible" guidelines and these loans also tend to be highly concentrated in a specific area -- the rating agencies look for, among other factors, a net risk-to-capital ratio of 10:1, or below, for investment grade ratings on state-sponsored single-family mortgage insurance funds. For entities that primarily insure multi-family loans, the rating agencies look for a stronger reserve ratio, given the additional risks endemic to such projects.

   **Mississippi Home Corporation will use a 10:1, or below, risk-to-capital ratio on the single-family homes it will help insure.**

2. *Size and Quality of Insured Portfolio:*

While mortgage insurance funds have various amounts of risk in force, the rating agencies believe the larger an individual pool of insured funds and the larger the amount of risk in force in such a pool, that the portfolio's performance will become more predictable in terms of its default rates and expected losses. For an investment grade rating, among other credit factors, the rating agencies will expect a book of business large enough to find comfort in such assumptions.

**Mississippi Home Corporation has over ten years of experience with a pool of mortgage-backed securities whose total gross volume of loans remains consistently above $500.0 million.**

**Given such experience, and with such volume, Mississippi Home Corporation believes it can well predict the behavior of its self-insured portfolio, which from executing this proposal will:**

- **Put (a conservative level) $1.0 million of gross risk in force,**
- **Leverage $10.0 million in mortgage loan principal of the FannieMae "Home Run" program and**
- **Enable about 150 Mississippi working families to buy a home.**

3. *Liquidity:*

This is not a major factor for most private or state-sponsored mortgage insurers, because default losses do not tend to emerge in huge, single events (unlike in some property and casualty cases – hurricanes and earthquakes). Rather, default losses tend to emerge over several years. Additionally, such mortgage insurers tend to have highly rated and liquid investments.

Indeed, HFA investment portfolios are conservative – coupled with the attributes of highly liquid and marketable investments, because their business requires them to be so. Consequently, the rating agencies do not expect any material changes to the investment policies of such state-managed funds, at least, over the mid-term.

**Mississippi Home Corporation has no plans to alter its extremely successful investment strategy, which maintains conservative, liquid and highly marketable securities.**

4. *Profitability:*

Clearly, as with any ongoing business activity, profitability is an important financial factor. According to Fitch IBCA's 1998 comparable financial ratings of the state HFA's – the most current full-year and inclusive ranking – while Mississippi Home Corporation ranked 47th in Total Assets, Mississippi Home Corporation ranked:

- 12th with its Net Income / Total Revenue ratio with 20.5 percent, while the national median was 14.7 percent and the national average was 15.4 percent and

- 4th with its Return on Equity with 18.7 percent, while the national median was 10.8 percent and the national average was 11.0 percent.

**Given the current market conditions and the year-to-date performance of the Mississippi Home Corporation's investments, other than the possible "bookkeeping" ramifications of GASB 31, Mississippi Home Corporation sees no reason why its profitability should drop below other entities of similar investment grade.**

5. *Loss History:*

The importance of strong underwriting for state mortgage insurers is critical, as losses can erode premium (or principal) and interest earnings, which are the primary revenue producers for these funds. The rating agencies have reported that, despite the fact that many of the loans insured under these pools or funds are considered relatively risky, the historical loss rates, particularly for most single-family and multi-family portfolios, has been surprisingly low.

**Since its inception in 1990, the Mississippi Home Corporation has maintained a strong position in the mortgage-backed securities market place. The Corporation issues Aaa rated bonds, evidencing its issue structures and loss histories are well accepted by investors.**

6. *Management and governance:*

Most state mortgage insurers are managed by the same generally sophisticated management team that directs the HFA's very successful single-family and multi-family programs. In large part, the success of HFA single-family programs, private mortgage insurance companies and their regulators have stretched certain underwriting criteria to conform with many state mortgage insurance funds.

As example, up until four years ago, private insurers could only insure loans up to 95 percent loan to value (LTV). However, now, private mortgage insurers are permitted to go up to 97 percent of loan to value. According to the rating agencies, this increase in flexibility was directly related to the success of state-sponsored single-family programs – given the low delinquency rates experienced by the state mortgage insurers for these higher LTV loans.

**Succinctly, it comes down to this:**

**An entity's financial strength ratings (as ascribed by the rating agencies) are opinions of the ability of the entity as an insurer to punctually re-pay policy holder claims and obligations.**

**The management and governance of the Mississippi Home Corporation, over its ten-year life has proved capable to:**

- **Meet its capital and fiduciary responsibilities,**
- **Issue Aaa rated mortgage-backed securities,**
- **Create enviable profit margins and**
- **All without the benefit of any state financial support for its operations.**

The following table exhibits the states that are engaged in this business, their inception and their ratings.

**A Comparison of the State-Sponsored Programs**
**("Net Risk" is in Thousands of Dollars.)**

| State Fund | Rating | Created | Net Risk | Risk-to-Capital |
|---|---|---|---|---|
| California Housing Loan Insurance Fund | Aa3 | 1977 | 345,000 | 8.4 : 1 |
| Florida Affordable Housing Guarantee | NR | 1992 | 324,000 | 4.95 : 1 |
| Maryland Housing Fund – MF | NR | 1971 | 354,000 | 8.7 : 1 |
| Maryland Housing Fund – SF | NR | 1971 | 418,000 | 11.7 : 1 |
| Massachusetts Mortgage Insurance Fund | A2 | 1988 | 134,000 | 2.1 : 1 |
| State of New York – Pool | Aaa | 1989 | 247,000 | 3.5 : 1 |
| State of New York – Project | Aa1 | 1978 | 1,860,000 | 3.97 : 1 |
| Pennsylvania Housing Insurance | NR | 1990 | 107,000 | 2.1 : 1 |
| Vermont Home Mortgage Guarantee | Aa2 | 1973 | 116,000 | 30.1 : 1 |

**Source: Moody's Investors Services, Moody's Housing Finance, October 1999.**

*Overview of Two State Programs*

The following narrative examine two existing programs:

1. State of New York Mortgage Agency – Mortgage Insurance Fund and

2. Pennsylvania Housing Insurance Fund.

*New York State Mortgage Insurance Fund*

In 1978, the state of New York established its own mortgage insurance fund to combat "red-lining" and encourage the rehabilitation of deteriorating neighborhoods throughout the state. Accordingly, the "Mortgage Insurance Fund" (MIF) was created and administratively placed within the State of New York Mortgage Agency (SONYMA). The MIF enabling legislation authorized the agency to provide primary mortgage insurance for single-family, multi-family and commercial structures in blighted areas, as well as, for public-purpose facilities.

In 1989, the MIF was authorized to write pool insurance on single family mortgage loans provided by SONYMA's “Single Family Programs and Financing Division”. In addition to providing the pool insurance coverage for over $1.9 billion or 55 percent of SONYMA existing mortgages, MIF is the current pool insurer for all of SONYMA's programs, and MIF is able to offer more flexible underwriting guidelines at a lower cost than the private insurers, which are the two factors of programmatic significance to SONYMA's Single Family Programs and Financing Division.

The success of the MIF in meeting the needs of communities across New York State is clearly demonstrated by its extensive portfolio of approximately $7.0 billion of insured mortgages and commitments to insure and the continuing upward trend in activity.

The Mortgage Insurance Fund derives its funding primarily from a 25 cents per $100 surcharge on the State's mortgage recording tax, as well as from premiums, fees, and interest earnings. The MIF has two programmatic underwriting units: Project Mortgage Insurance and Single Family Mortgage Insurance.

*Pennsylvania Housing Insurance Fund*

The Pennsylvania Housing Insurance Fund (PHIF) was established in 1990 as a division within the Pennsylvania Housing Finance Agency (PHFA). PHIF retains the risk of mortgagor default on loans originated for and purchased by PHFA through its “Single Family Homeownership and / Mortgage Revenue Bond” (MRB) programs in a manner similar to a private mortgage insurer.

Buyers who are unable to provide a 20 percent down-payment require either government-backed insurance or guarantees such as those offered by FHA, RHS or VA, or private mortgage insurance. For some borrowers who cannot qualify for those programs, PHFA self-insures their loans against default.

However, PHIF is not a mortgage insurance company, rather it is an alternative credit enhancement vehicle, created to help the PHFA reach its targeted homebuying population. PHIF exists as a dedicated fund within the PHFA’s General Fund and maintains an independent staff of underwriters to review loan submissions. As an internal risk-retention and self-insurance vehicle, PHIF deals only with PHFA MRB loan submissions.

*Conclusion*

To augment its other efforts, and help the Mississippi Home Corporation increase the supply of safe, decent and affordable housing in the Lower Mississippi Delta Region, the Corporation proposes that:

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