VANDERBILT Ave.
ASSET MANAGEMENT

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President Trump Reverses the Cut in Mortgage Insurance Premium

In his last days in the White House, President Obama signed legislation that had been floating around for over a year. He lowered the Mortgage Insurance Premium (MIP) for FHA loans from 0.85% to 0.60%. As soon as President Trump took office, he reversed the MIP back to 0.85%. The movement of this rate down, and back up, has impacted both the Mortgage Backed Securities ("MBS") market, as well as garnering divisive media responses. We will discuss both of these points in turn, but first let's get some background on FHA loans and MIP.

FHA Loans vs. Conventional Loans

In order to facilitate more borrowers in purchasing homes, the government's Federal Housing Administration ("FHA") program lends borrowers with FICO scores as low as 580 up to 96.5% of the value of their home. If borrowers default on these loans, FHA takes the loss. In order to protect itself from defaults, the FHA requires borrowers in this program pay Mortgage Insurance Premium ("MIP") for the life of their loan. The MIP funds a reserve account that pays out when borrowers default. As a result of foreclosures that haunted the financial crisis, the FHA used all of the funds in its reserves and incurred an additional $16 billion loss. In order to protect itself going forward, the FHA instituted higher MIP rates and also made MIP permanent for the life of the loan; previously MIP would have been canceled when the loan-to-value ratio ("LTV") of the loan reached 78%. The table below outlines MIP changes over the last several years. Once the reserves were back on target, the FHA began dropping the MIP, but continued to hold it at above-crisis levels.

Change Date	Upfront MIP	Monthly MIP
Before July 2008	1.50%	0.55%
Jul-08	1.25%-2.25%	0.55%
Oct-08	1.75%	0.55%
Apr-10	2.25%	0.55%
Oct-10	1%	0.90%
Apr-11	1%	1.15%
Apr-12	1.75%	1.25%
Apr-13	1.75%	1.35%
Jan-15	1.75%	0.85%

In contrast to FHA loan borrowers who pay MIP, conventional mortgage loan borrowers must have stronger credit and can subsequently pay less insurance. Specifically, they require a minimum FICO score of 620 and

their Private Mortgage Insurance ("PMI") can range from 0.3% to 1.5% per year of the original loan amount, depending on their credit score. Conventional loans require 5% down payment, as opposed to 3.5% for FHA, and the PMI can be removed when LTV reaches 80%.

When FHA and conventional loans are pooled and securitized the latter are sold to investors as Fannie Mae or Freddie Mac agency guaranteed MBS, while the former are sold as Ginnie Mae *government guaranteed* MBS. As we learned from history, when the government's mortgage premium reserve dwindles, it still continues to guarantee these securities, but tax payers pick up the tab.

Recent Media Coverage of the MIP rate cut reversal

So now let's analyze the recent cut, cut reversal, and media coverage of both. The MIP rate cut was lauded as a necessary opportunity for low income borrowers to become homeowners. Since FHA borrowers are buying homes at very tight margins, a drop of just 0.25% in the MIP can actually bring their debt-to-income ratios in line enough to qualify for a mortgage. The important question to note, however, is: *At whose expense*?

The financial crisis was a by-product of easy mortgage money, with tax payers paying the tab both directly, through tax increases, and indirectly through an economic recession. By dropping the MIP, the FHA runs the risk of being short if another crisis hits, and again putting pressure on tax payers. Instead, the MIP will remain at existing levels for now and the government's reserve for potential defaults will remain strong.

The Main Street to Wall Street Connection

Upon announcement of MIP cut, FHA mortgage applications increased 47%, as more borrowers' debt-to-income ratios were set to qualify for a mortgage. At the same time, the performance of MBS dragged, driven by underperformance of Ginnie Mae securities. When the MIP rate cut reversal was announced, MBS performance improved, again driven by outperformance of Ginnie Mae securities.

At this juncture, the MIP cut is off the table. MBS are still underperforming for the month of January, though less so than they were when the MIP cut was impending, and ultimately announced. At least for now, the government is keeping its stronghold on the purse that it uses to guarantee the loans that fall under its umbrella.

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Emad is the Managing Partner and Chief Executive Officer of Vanderbilt Avenue Asset Management LLC. Vanderbilt's client base includes Multi-national Corporations, Public Funds, Foundations/Endowments, and Taft Hartley accounts.

Previously, Emad was Chairman of Institutional Business at Pioneer Investments. Pioneer investments has more than $300 Billion in assets under management. The parent of Pioneer, UniCredit S.p.A., is the largest bank in Italy and the second largest bank in Europe. Pioneer had purchased Vanderbilt Capital Advisors, of which Emad was the founder and Chief Executive Officer.

Emad has had numerous articles published in professional and academic journals such as *The Journal of Forecasting*, *The American Economist* and *The Journal of Fixed Income*. He is a Board member of The National Investment Company. Emad was a member of the Board of Advisors of the Pacific Institute, The Advisory Committee of Fulcrum Global Partners, The Chief Executive Officers Club and formerly a board member of The Foreign Policy Association. He also served on the Board of Directors of the University of Albany Foundation, NextGen Healthcare Inc., The Park Avenue Bank, AA Bank and The New Providence Fund and Associates LP.

Emad is an FINRA Arbitrator. He is also a member of the National Association for Business Economists and The Economic Club of New York. Emad served as an adjunct professor at the University of Kansas and St. John's University.

Emad holds a Bachelor of Science from the University of Albany, and a M.A. and Ph.D. in Economics from the University of Kansas.