



October 24, 2012

FHFA Adjustment to State-Level Guarantee Fee Pricing

EXECUTIVE SUMMARY

- The Federal Housing Finance Agency (FHFA) oversees the operations of Fannie Mae and Freddie Mac (“GSEs”).
- This Notice sets forth an approach to adjust the guarantee fees (“g-fees”) that the GSEs charge for mortgages that finance properties with one to four units (“single-family mortgages”) in certain states to recover a portion of the exceptionally high costs that the GSEs incur in cases of mortgage default in those states.
- FHFA’s approach would focus on the five states with the average total carrying costs that significantly exceed the national average and, therefore, impose the greatest costs on the GSEs and taxpayers. Mortgages originated in Connecticut, Florida, Illinois, New Jersey, and New York would have an upfront fee of between 15 and 30 basis points, which would be charged to lenders as a one-time upfront payment on each loan acquired by the GSEs.
- The FHFA is accepting public comments until November 26, 2012. **Please send your comments to CUNA by November 12.**

Please send comments to Senior Vice President and Deputy General Counsel [Mary Dunn](#) and Assistant General Counsel [Luke Martone](#). [Click here](#) for the notice.

BACKGROUND

The GSEs charge g-fees to compensate for the credit risks they undertake when they own or guarantee mortgages. Current g-fees for single-family mortgages vary with the type of loan and with loan and borrower attributes that affect credit risk. The single-family g-fees that the GSEs charged prior to conservatorship proved inadequate to compensate for the level of actual credit losses they experienced. This contributed directly to substantial cost to taxpayers.

G-fee payments to the GSEs generally include both ongoing monthly payments and an upfront payment at the time of GSE loan acquisition.

Recent experience has shown a wide variation among states in the costs that the GSEs incur from mortgage defaults. This is due, in large part, to differences among the states and territories in the requirements for lenders or other investors to manage a default, foreclose, and obtain marketable title to the property backing a single-family mortgage. Because the GSEs currently set their g-fees nationally, accounting for expected default costs only in the aggregate, borrowers in states with lower default-related carrying costs are effectively subsidizing borrowers in states with higher costs.

The principal drivers of differences across states in the average total carrying costs to the GSEs of a defaulted single-family mortgage are, in order of importance:

- The length of time needed to secure marketable title to the property;
- Property taxes that must be paid until marketable title is secured; and
- Legal and operational expenses during that period.

This Notice describes FHFA's proposal that would adjust the upfront fees that the GSEs charge when they acquire single-family mortgages in states where GSE costs that are related to state foreclosure practices are statistically higher than the national average.¹ The size of the adjustments would reflect differences in costs in those states from the average.

This Notice outlines the approach that FHFA is considering and discusses potential additions and changes to the calculation of such fees in the future. After reviewing public input and determining a final state-level guarantee fee pricing method, FHFA expects to direct the GSEs to implement the pricing adjustments in 2013.

DESCRIPTION OF NOTICE

Approach to State-Level G-Fee Adjustments

The approach set forth in this Notice is based on GSE experience and does not include the forward-looking impact of recently-enacted state and local laws that may increase the GSEs' costs. FHFA intends to periodically reassess state-level pricing based on updated GSE data. The agency may include the impact of newly-enacted laws if they clearly affect foreclosure timelines or costs.

FHFA's approach would focus on the small number of states that have average total carrying costs that significantly exceed the national average and, therefore, impose the greatest costs on the GSEs and taxpayers. Mortgages originated in these highest-cost states would have an upfront fee of between 15 and 30 basis points, which would be charged to lenders as a one-time upfront payment on each loan acquired by the GSEs. Based on current data, those five states are Connecticut, Florida, Illinois, New Jersey, and New York.

Lenders may pass an upfront fee through to a borrower as an adjustment to the interest rate on the borrower's loan. Because the upfront fee is paid only once, its impact on the annual interest rate is much smaller than the upfront fee itself. Dividing the upfront fee by five provides an approximation of the potential impact on the interest rate. To illustrate, a 15 basis point upfront fee, if fully passed through by the lender, would be roughly equivalent to an increase in the annual interest rate of 3 basis points. Under FHFA's planned approach, a homeowner in an affected state obtaining a 30-year, fixed rate mortgage of \$200,000 could see an increase of approximately \$3.50 to \$7.00 in his or her monthly mortgage payment, reflecting a range of upfront fee adjustments of 15 to 30 basis points.

The methodology used by the agency to develop the planned approach addresses only differences in the expected cost of defaults associated with single-family mortgages that will be acquired by the GSEs in the future and are underwritten according to current standards. If FHFA had developed an approach using information on the realized default losses on loans the GSEs acquired in the past decade, which were originated under less stringent underwriting guidelines, the increases in upfront fees in the states affected would be significantly greater, because recently acquired mortgages are expected to default at lower rates due to strengthened underwriting standards.

Methodology

The methodology used to develop the planned approach to state-level g-fee pricing relies on the following key factors:

- The expected number of days that it takes an GSE to foreclose and obtain marketable title to the collateral backing a mortgage in a particular state.
- The average per-day carrying cost that the GSEs incur in that state.
- The expected national average default rate on single-family mortgages acquired by the GSEs.

To estimate the magnitude of the state-level differences in average total carrying cost, the estimation assumes that loans originated in each state will default at the national average default rate.

¹ This proposal would increase the amount of g-fees that the GSEs charge on mortgages originated in the highest cost-of-default states. This proposed increase is indirectly related to the approach outlined in the [FHFA's Strategic Plan for 2013-2017](#) that provides for an overall increase in g-fees as they apply to all states.

ESTIMATED TIME TO OBTAIN MARKETABLE TITLE AND COST PER DAY RELATIVE TO THE NATIONAL AVERAGE

State ¹	Foreclosure timeline in days ²	Estimated average "unable-to-market" time in days	Total time to obtain marketable title in days	Cost per day relative to the national average ³ (%)	Rank (total time * cost) ⁴
AK	300	0	300	93	11
AL	270	0	270	93	2
AR	280	0	280	102	13
AZ	300	0	300	84	3
CA	300	0	300	90	7
CO	330	0	330	85	12
CT	690	0	690	109	52
DC	300	0	300	86	5
DE	480	0	480	83	27
FL	660	0	660	111	51
GA	270	0	270	101	9
GU	500	0	500	100	38
HI	500	90	590	79	35
IA	480	0	480	110	42
ID	440	0	440	88	26
IL	480	60	540	118	50
IN	480	0	480	107	40
KS	330	90	420	108	33
KY	420	30	450	97	32
LA	390	0	390	106	29
MA	350	0	350	97	22
MD	485	120	605	97	49
ME	570	0	570	95	44
MI	270	180	450	118	43
MN	270	180	450	96	30
MO	270	0	270	109	17
MS	270	0	270	107	14
MT	360	0	360	88	20
NC	300	0	300	91	10
ND	405	60	465	109	39
NE	330	0	330	114	25
NH	270	0	270	110	18
NJ	750	0	750	113	53
NM	450	60	510	91	34
NV	360	0	360	83	19
NY	820	0	820	112	54
OH	450	30	480	114	45
OK	420	0	420	104	31
OR	330	0	330	88	16
PA	480	0	480	108	41
PR	720	0	720	68	37
RI	330	0	330	107	23
SC	420	0	420	95	28
SD	360	180	540	105	46
TN	270	0	270	96	6
TX	270	0	270	132	24
UT	330	0	330	82	8
VA	270	0	270	87	1
VI	510	0	510	93	36
VT	510	30	540	105	47
WA	330	0	330	88	15
WI	480	30	510	113	48
WV	290	0	290	87	4
WY	270	120	390	86	21
National Average (UPB Weighted)	396	17	413	100	

¹ Includes the District of Columbia and certain U.S. territories. The Enterprises do not currently acquire loans in the Northern Mariana Islands or American Samoa.

² Foreclosure time frames are available online at: <https://www.efanniemae.com/st/guides/ssg/relatedservicinginfo/pdf/foreclosuretimeframes.pdf> and <http://www.freddiemac.com/learn/pdfs/service/exhibit83.pdf>.

³ Cost per day is expressed as an index relative to the UPB-weighted national average, where 100% represents the average cost. It excludes HARP loans.

⁴ Rank is a function of the total time to obtain marketable title multiplied by the indexed cost. The product for each state is indicative of the relative total carrying cost upon which FHFA would base its adjustments to upfront fees. "1" represents the lowest-cost area and "54" the highest-cost area.

The first two factors—days to obtain marketable title and per-day carrying costs—provide estimates of the total carrying cost of a defaulted mortgage, by state. The third factor used in the methodology is the expected national average default rate on single-family mortgages acquired by the GSEs.

The planned approach focuses on the small number of states that have expected total default-related carrying costs that significantly exceed the national average and, thus, cause the greatest increase in average loss given default. Based on current data, loans in five states would be assessed upfront fees. The state between one and one half and two standard deviations from the mean, Illinois, would have an upfront fee of 15 basis points. The states between two and three standard deviations from the mean, Florida, Connecticut, and New Jersey, would have an upfront fee of 20 basis points. The state more than three standard deviations from the mean, New York, would have an upfront fee of 30 basis points.

This approach would allow for variation in practice among the states and impose upfront fees only on those states that are statistical outliers from the rest of the country. If those states were to adjust their laws and requirements sufficiently to move their foreclosure timelines and costs more in line with the national average, the state-level, risk-based fees imposed under the planned approach would be lowered or eliminated. The approach recognizes that each state establishes legal requirements governing foreclosure processing that it judges to be appropriate for its residents. It also recognizes that unusual costs associated with practices outside of the norm in the rest of the country should be borne by the citizens of that particular state rather than absorbed by borrowers in other states or by taxpayers.

Future Changes to State-Level G-Fee Adjustments

The planned approach bases state-level adjustments to upfront fees on past experience and a limited range of cost variables. FHFA would consider, in the future, changes to its methodology to address additional variables. For example, these could include estimates of the impact of recently-enacted laws and ordinances. Such calculations would be based on experience with similar laws and ordinances and their effects on per-day carrying costs. FHFA could also include a wider range of state actions in its methodology. For example, FHFA could consider state laws and ordinances affecting the disposition of acquired real estate following a default, commonly referred to as real estate owned (REO), and address attendant costs created by state and local rules that impose charges above a certain amount or impose duties that add to the costs of the GSEs. The GSEs, therefore, could undertake revisions to their state-level g-fees based on experience gained with additional measurement devices.

QUESTIONS TO CONSIDER

- 1) Generally, do you support the FHFA's proposed approach of singling-out the states with the highest average total carrying costs to the GSEs of a defaulted single-family mortgage?

- 2) Do you foresee any ways in which the proposed approach could disadvantage credit unions and/or other smaller lenders?

- 3) Is standard deviation a reasonable basis for identifying those states that are significantly more costly than the national average?

- 4) Should finer distinctions be made between states than the approach described here?

- 5) Should an upfront fee or an upfront credit be assessed on every state based on its relationship to the national average total carrying cost, such that the net revenue effect on the GSEs is zero?

- 6) Any other comments or questions.
