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INSIGHT

The GSEs' Adverse Market Refinance Fee

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Fannie Mae and Freddie Mac, two government-sponsored enterprises (GSEs), were chartered by Congress to provide liquidity for both the single- and multi-family mortgage markets. In the years following the housing and mortgage market turmoil beginning in 2007, the GSEs experienced financial difficulty. On September 6, 2008, the Federal Housing Financial Agency (FHFA), the GSE's primary regulator, took control of them from their stockholders and management in a process known as conservatorship. FHFA has since implemented various initiatives to improve the GSEs' financial conditions, and it has recently prioritized their exit from conservatorship. Specifically, the GSEs are now being allowed to accumulate capital reserves to buffer against mortgage default risks, and FHFA has re-proposed a rule to establish a capitalization framework that would be in place following their return to stockholder control.

On August 12, 2020, both Fannie Mae and Freddie Mac announced an *adverse market refinance fee* of 50 basis points (0.5%) on the cash-out refinance loans purchased by the GSEs as of September 1, 2020. The fee would also apply to Fannie Mae's limited cash-out refinance and Freddie Mac's no cash-out refinance products, which cap the amount of home equity borrowers can withdraw, typically to roll some or all of the closing costs into their mortgages. (For both GSEs, single-close construction-to-permanent refinances would be exempt from the fee.) If, for example, a lender sold a refinanced mortgage of $300,000 to a GSE, the lender would be charged a fee of 0.5%, or $1,500.

The additional revenue collected by the GSEs could be used for multiple purposes. In general, the GSEs guarantee investors in their mortgage-backed securities (MBSs) timely repayment of principal and interest generated from the underlying mortgages linked to the MBSs. By granting forbearance (i.e., deferred mortgage payments) to borrowers adversely affected by the Coronavirus Disease 2019 (COVID-19) pandemic, some mortgages are not generating cash flows even though they technically are not in default. For this reason, the GSEs may be experiencing challenges to their cash flows by attempting to forward payments to investors that hold their MBSs while simultaneously providing forbearance to borrowers affected by COVID-19. The revenue generated by the 0.5% fee could offset these cash flow pressures facing the GSEs and allow them to continue meeting their payment obligations without experiencing severe cash flow shortfalls. Given that the GSEs have received funds from Treasury while under conservatorship, the 0.5% fee might reduce or abate the need for additional support. If fewer forbearances and defaults than anticipated occur such that cash flow disruptions are averted, the additional revenues could also be used to accumulate more capital reserves to facilitate the GSEs' exit from conservatorship sooner rather than later. Predicting how much revenue the fee would generate for the GSEs is difficult

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because of the challenges in predicting how many additional homeowners would refinance by September 1, 2020, particularly given that many people have already refinanced.

When a tax or fee is imposed on a product or service, it can be paid by either the demand or supply side of the market in relatively equal or unequal portion sizes. Likewise, after the 0.5% fee is imposed on a refinanced mortgage product, either the borrowers or mortgage originators can pay relatively equal or disproportionate amounts. For this reason, the effects of the 0.5% fee on borrowers and mortgage originators are uncertain.

- Mortgage originators might be able to pass some or all of the fee onto borrowers. As previously stated, borrowers could opt to roll the additional fee into the mortgage and pay it over the life of the loan. Alternatively, some or all of the 0.5% could be rolled into the closing costs fees. Originators are required by law to disclose the fees borrowers pay when they close on a mortgage; however, the higher fees still may not deter some borrowers from refinancing especially if their total mortgage cost savings over time would substantially offset the 0.5% fee.
- If unable to pass all or a large portion of the fee onto borrowers, then originators could adjust or switch business models. One response could be to stop selling eligible mortgages to Fannie or Freddie particularly for firms in which originating mortgages is not a significant part of their overall business models. Originators that are principally engaged in collecting origination fees from large volumes of mortgages for sale to the GSEs, however, would consider whether they can still generate sufficient revenues to cover most of the expenses per loan. If their primary source of income is generated from mortgage origination fees, then it could become difficult to quickly switch from and adopt new business models despite incurring higher costs.

Some Members of Congress have expressed concern, some directly to FHFA, regarding the fee.

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