Congressional Research Service
Informing the legislative debate since 1914

INSIGHT

The Impact of COVID-19-Related Forbearances on the Federal Mortgage Finance System

Andrew P. Scott
Analyst in Financial Economics

May 13, 2020

One of the major economic impacts of the Coronavirus Disease 2019 (COVID-19) pandemic has been loss of income, which has left many Americans unable to repay their financial obligations—including their mortgage payments. In response, regulators have encouraged financial institutions to work with customers to allow them to defer payments on mortgages through a process known as *forbearance*. Provisions in the CARES Act (P.L. 116-136) require mortgage servicers to provide several months of forbearance to borrowers (at the borrowers' requests, after they demonstrate a COVID-19-related financial hardship) with a federally backed mortgage. This Insight explains the term *federally backed mortgage* and examines some of the potential impacts that forbearance on these mortgages may have on the mortgage finance system.

What Is a Federally Backed Mortgage?

With respect to the CARES Act, a federally backed mortgage generally includes mortgages that are either insured, guaranteed, or made directly by the Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), Department of Agriculture (USDA), and the Department of Veterans Affairs (VA), or has been securitized by Fannie Mae or Freddie Mac (collectively referred to as the government-sponsored enterprises, or GSEs) in the form of mortgage-backed securities (MBS). Additionally, Ginnie Mae—a federal agency within HUD—guarantees MBS that are composed entirely of mortgages that are guaranteed by federal agencies (such as FHA). GSE and Ginnie Mae securitization comprises over 60% of the $11 trillion in outstanding mortgage debt and over 95% of residential MBS.

Congressional Research Service
7-....
www.crs.gov
IN11385

COVID-19 Forbearances and the Mortgage Finance System

Forbearance allows borrowers to temporarily defer payments until they may be better able to meet their financial obligations. It is not loan forgiveness—the consumer ultimately needs to make payments that are deferred—but deferred payments can be made up in a number of ways, including

- making a lump sum repayment at the end of the forbearance period,
- adding onto the existing monthly payments over a set number of months, or
- adding to the end of the mortgage as additional payments or as a lump sum.

Federal agencies like the Federal Housing Finance Agency (FHFA)—the GSEs' regulator—have signaled that borrowers with federally backed mortgages will not have to pay their mortgages back in one lump sum at the end of forbearance.

Recent reports suggest that as of April 26, 7.5% of mortgages are currently in forbearance (up from 0.25% as of March 2). However, the impact of these forbearances on the mortgage finance system will depend on a variety of factors, including the type of institution, the duration of forbearance, and consumers' ability to repay the deferrals and resume making monthly mortgage payments once forbearance has ended.

Impacts on the Mortgage Finance System

The mortgage finance system comprises two markets: the primary market where mortgages are made and serviced, and the secondary market where mortgages are sold, securitized, and traded. A mortgage can be originated by a bank, credit union, or other financial institution when a consumer buys a home or refinances an existing mortgage. Federal agencies such as the FHA, VA, and USDA insure and guarantee many of these mortgages. The originator or another institution act as mortgage servicers, managing the administration of the loan. In addition to collecting payments from the borrower and remitting payments to the lender, mortgage servicers also manage circumstances where borrowers cannot make payments in full, such as forbearance. Although mortgage servicers operate in the primary market, if a loan is sold and securitized in the secondary market (often by a GSE), the servicers are responsible for remitting payments to MBS investors even if the borrower does not make their payments.

Near-term Impacts

In the near term, the brunt of the impact is likely to be felt by mortgage servicers: as consumers request and receive forbearance on their mortgage obligations due to COVID-19, some mortgage servicers may face the prospect of becoming illiquid. Black Knight, Inc. (a data provider that tracks data from public property records, mortgage listings, and outstanding loans) has estimated that as of May 7, 2020, 4.1 million homeowners—about 7.7% of all mortgages—have entered into COVID-19-related mortgage forbearance, representing more than $890 billion in unpaid principal. According to the analysis, mortgage servicers are bound to advance an estimated $4.5 billion per month to investors and lenders of government-backed loans in forbearance. Of this amount, $2 billion per month is due to the GSEs. While the FHFA recently announced that it would only require servicers to advance four months of payments on loans in forbearance to the GSEs, this still leaves servicers exposed to around $8 billion in advances.

One way mortgage lenders can mitigate the risks of having mortgages on their balance sheet is to sell their mortgages in the secondary market. However, as mortgage forbearance picks up, lenders may have a harder time selling mortgages to investors in the secondary market, as investors would typically be less willing to purchase mortgages that are not earning revenue. The FHFA recently announced that the GSEs will purchase some qualifying loans that are in forbearance from lenders in response. The uptick in mortgage forbearance, however, may also lead originators to require borrowers to have higher credit scores or reduce mortgage originations.

Longer-term Impacts

If a large share of borrowers ultimately cannot resume mortgage payments, resulting in foreclosures, the impacts could extend to federal agencies, which insure and guarantee federally backed mortgages. The FHA, VA, and USDA are exposed to losses if a borrower eventually defaults on a mortgage.

Further, the impacts could increase counterparty risk for the secondary market guarantees provided by Ginnie Mae and the GSEs, which guarantee the payment of principal and interest on their MBS to investors. As of April 26, COVID-19-related forbearance was highest among mortgages backed by Ginnie Mae (at 10.5%) compared with mortgages held by private lenders (8.3%) or backed by other federal agencies (5.9%).