A New Mortgage Penalty Is Blocking Homeownership and Refinancing Opportunities for 255,000 Borrowers

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It is significantly harder for borrowers with less-than-pristine credit to qualify for a mortgage today than it was just four months ago. This means borrowers with low credit scores—a group disproportionately composed of first-time homebuyers and Black and Hispanic homebuyers—cannot qualify for a mortgage today that they would have qualified for four months ago. These families include current homeowners who want to refinance their mortgage to take advantage of record-low mortgage rates or tap into home equity to help carry them through the COVID-19 crisis. These families could also be renters who have assembled the resources to buy a home and are among the 89 percent of Americans who are still employed. The tightened credit atmosphere means these renters cannot move into homeownership to free up rental space for others and lock in monthly housing costs at a time of increasing and widespread financial insecurity.

A significant contributor to tightening credit standards is the new penalty imposed by the Federal Housing Administration (FHA) and the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac on lenders whose loans go into forbearance before they are delivered to Ginnie Mae or the GSEs to be packaged into securities. Lenders have added additional filters to their underwriting process to weed out homebuyers who might quickly go into forbearance on their new mortgage and trigger this penalty. We estimate that this will result in a minimum of 1 percent fewer purchase loans and 5 percent fewer refinance loans. Applying these estimates to publicly available industry forecasts of 2020 originations implies that the new penalties will limit homeownership and refinancing opportunities for approximately 255,000 creditworthy borrowers.

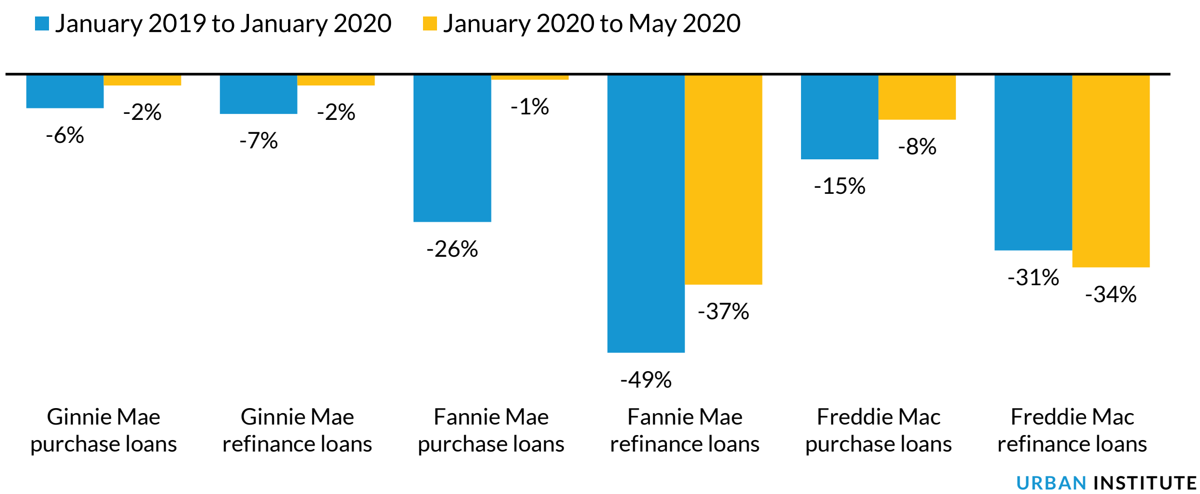
The data show that the maximum income the government could derive from this penalty is $53.4 million. To put this in perspective, GSE profits for 2019 were $23.4 billion, and Ginnie Mae contributes $1.7 billion to the US Treasury annually, so it makes no sense to prevent over 200,000 creditworthy homeowners and homebuyers from accessing homeownership or lower mortgage rates for the sake of $53.4 million.

It Is Much Harder to Get a Mortgage Today Than It Was Just Three Months Ago

The Mortgage Bankers Association's Mortgage Credit Availability Index shows an 18.4 percent tightening in Ginnie Mae loans and a 16.7 percent tightening in GSE loans between March and June 2020.[1] Together, Ginnie Mae, Fannie Mae, and Freddie Mac insure or guarantee more than 70 percent of the outstanding mortgages in the United States (Goodman et al. 2020).

FIGURE 1

Reduction in Mortgage Borrowers with FICO Scores below 700

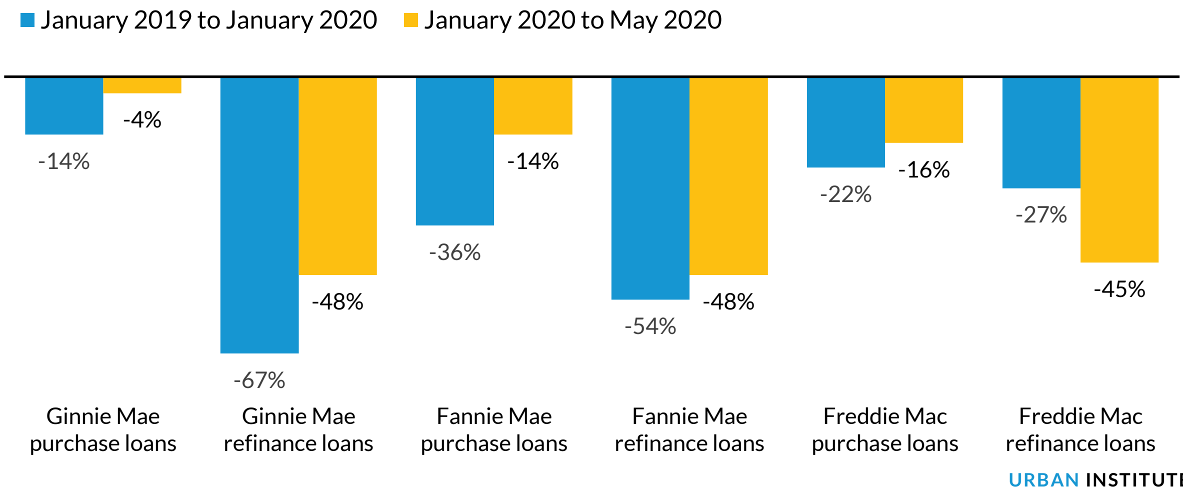


Source: Urban Institute calculations from eMBS data.

Note: This figure measures the change in the share of borrowers with FICO scores below 700.

FIGURE 2

Reduction in Mortgage Borrowers with FICO Scores below 700 and Debt-to-Income Ratios above 40 Percent



Source: Urban Institute calculations from eMBS data.
Note: This figure measures the change in the share of borrowers with FICO scores below 700 and debt-to-income ratios above 40 percent.

The data we examined also show that credit tightened for mortgages originated by any government-related entity between January 2019 and January 2020, and it tightened further from January to May 2020. Figures 1 and 2 show that when you take debt-to-income ratios and FICO scores into account, the credit tightening is even more dramatic.

Figure 2 reveals that the greatest tightening occurred among borrowers with low FICO scores and high debt-to-income ratios who seek to refinance their mortgages. Access for these borrowers dropped at least 45 percent between January and May 2020 across all three channels.

This greater tightening in refinance loans is important because the data on refinance loans is more recent than the data on purchase loans because purchase loan data take two months longer to move from closing to showing up in the securitization reports we examined for these calculations. For example, the June 2020 securities reports have information about April 2020 refinance loans and February 2020 purchase loans. So these data on refinance loans may offer insight into what the data on purchase loans will look like in another two months.

The New Presale Forbearance Penalty Is a Significant Contributor to Recent Tightened Credit

We have never had a situation in which forbearance has been institutionalized via congressional action, and the FHA and GSEs have been forced to come up with policies to address the situation in which the loan originator originates a loan in good faith and because of a change in circumstances, the borrower elects forbearance before the originator delivers the loans to Ginnie Mae or the GSEs. Fannie Mae and Freddie Mac now place an additional delivery fee of 5 percent for first-time homebuyers and 7 percent for all other purchase borrowers and rate-and-term refinances. Cash-out refinances that are in forbearance are not saleable at all. The FHA requires the servicer to absorb 20 percent of the eventual loss if the loan misses two payments in the first two years.

Conversations with servicers indicate the threat of this new penalty is contributing significantly to this recent tightening. Lenders know that they will pay this penalty on any loan that goes into forbearance before sale, so they are filtering out loans that could go into forbearance by reducing the time between loan closing and sale and imposing overlays on top of their traditional credit box.

It is true that servicing issues were also causing lenders, particularly nonbank originators with limited liquidity, to tighten lending to avoid cash-flow problems earlier this year (Kaul 2020), but this problem has been greatly diminished because of GSE policies to limit advances, Ginnie Mae's Pass-Through Assistance Program,[2] and the heavy wave of refinances, the timing of which gives servicers the use of the funds for a few weeks.

Few Loans Go into Forbearance before Being Sold into Securities

We believe this penalty is significantly limiting access to credit, but we also wanted to quantify the benefits of the penalty to the FHA and the GSEs. To do this, we looked at what share of loans might trigger this penalty and estimated the maximum amount of income these penalties might generate for the FHA and the GSEs.

The data reveal that a small share of loans go into forbearance before being sold to the FHA or the GSEs. (The GSEs now release data on the number of loans in each origination month in forbearance, beginning with loans originated in December 2019. Fannie Mae and Freddie Mac report the loans on a slightly different basis, with only Fannie Mae picking up loans that are both current and in forbearance, although Freddie Mac will do similar reporting going forward. Accordingly, our analysis focuses on Fannie Mae loans.)

TABLE 1

Fannie Mae Loans in Forbearance

	December 2019 to June 2020			May 2020			June 2020		
Coupon rate	Loans in forb.	Total loans	Share of total loans in forb.	Loans in forb.	Total loans	Share of total loans in forb.	Loans in forb.	Total loans	Share of total loans in forb.
Overall	64,598	2,135,661	3.0%	1,513	435,952	0.3%	12	425,660	0.003%
2.5%	13,585	896,078	1.5%	794	259,070	0.3%	8	237,001	0.003%
3.0%	31,453	684,993	4.6%	296	60,887	0.5%	2	57,334	0.003%
3.5%	10,231	188,322	5.4%	115	17,739	0.6%	1	9,188	0.011%
4.0%	5,123	74,251	6.9%	90	8,013	1.1%	0	4,074	0.000%
4.5%	2,215	33,056	6.7%	29	2,865	1.0%	0	4,685	0.000%
5.0%	533	5,392	9.9%	14	442	3.2%	0	129	0.000%

Source: Urban Institute calculations from eMBS data.

Note: forb. = forbearance.

Table 1 shows that 3 percent of loans issued between December 2019 and June 2020 are in forbearance. As would be expected, the forbearance rate is considerably higher for the higher-coupon mortgages, which are riskier mortgages overall, and a bit lower for the lower-coupon mortgages, which have less risk. These numbers include loans purchased in forbearance and those that have gone into forbearance since being securitized and sold to investors. Interestingly, the size of the loans going into forbearance are larger than the average loan size: $307,000 versus $276,000 (table 2).

TABLE 2

Average Loan Size of Fannie Mae Loans

Coupon rate	Among loans in forbearance	Among all loans
Overall	$306,787	$276,432
2.5%	$341,453	$301,317
3.0%	$316,761	$265,838
3.5%	$279,568	$214,763
4.0%	$252,890	$200,395
4.5%	$221,712	$170,412
5.0%	$211,210	$182,495

Source: Urban Institute calculations from eMBS data.

Loans made in May and June have much lower forbearance rates than the overall rate, at 0.3 percent and 0.003 percent, respectively. The most recent loans have lower forbearance rates because most borrowers would be in the same employment situation within a month of qualifying for the mortgage as they were when the mortgage was originated. In contrast, the longer the loan is outstanding, the greater the likelihood of a changed circumstance.

Note that a loan closed in May could have been in forbearance before purchase or it could have subsequently gone into forbearance. The May number a month ago was 0.04 percent. To be conservative, we will use this for the analysis rather than the lower June number.

The new penalty will reap $48 million, at most, for the GSEs for 2,400 early-forbearing loans. For the GSEs, we estimate the predicted penalty income would be, at most, $48 million, assuming (1) the average penalty is 6.5 points, (2) the GSEs buy 6 million loans this year, (3) the average loan size of a forborne loan is $307,000, and (4) 0.04 percent of them are in forbearance at purchase. That is, under these assumptions, the GSEs would be purchasing 2,400 loans in forbearance. This is an upper-bound estimate. If the share of loans purchased in forbearance was 0.02 percent, the estimate would be cut in half.

The new penalty will reap $5.4 million, at most, for the FHA for 1,350 early-forbearing loans. We have no data on the frequency of FHA loans that would experience presale forbearance, but we can provide a crude estimate. Mortgage Bankers Association forbearance numbers show that Ginnie Mae loans go into forbearance at 1.9 times the rate of GSE loans (11.72 percent for Ginnie Mae, 6.17 percent for the GSEs). Within the Ginnie Mae space, we assume that FHA loans are more likely to experience forbearance than US Department of Veterans Affairs loans. Assuming FHA loans are 2.25 times more likely than GSE loans to experience forbearance before a sale, it would suggest a presale forbearance rate of 0.0009 percent. If the FHA makes 1.5 million loans, our assumptions suggest that 1,350 loans would be affected. If we assume an average loan size of $250,000, assume that 20 percent of these borrowers miss two payments and the loss severity is 40 percent, and assume the servicers pay 20 percent of this, it would suggest a predicted penalty income of $5.4 million.

$53 million of government income from 3,750 early-forbearing loans is not worth the loss of mortgage access for more than 200,000 borrowers. Eliminating the penalties for selling loans made in good faith that subsequently go into forbearance before sale to the FHA or the GSEs would open access to credit for as many as 255,000 borrowers at a low cost. To eliminate the potential for abuse, the FHA and the GSE would need to make sure that loans sitting in a portfolio for months are not sold after they go into forbearance. This can be accomplished by eliminating the penalty for loans in forbearance only if they are sold no more than one month after closing.

Notes

1 "Mortgage Credit Availability Index," Mortgage Bankers Association, accessed July 17, 2020, https://www.mba.org/news-research-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index#:~:text=ABOUT%20THE%20MORTGAGE%20CREDIT%20AVAILABILITY,value%20ratio%2C%20etc.).

2 Ginnie Mae, "Ginnie Mae Announces Changes to Its Pass-Through Assistance Program in Response to COVID-19 National Emergency," press release, April 10, 2020, https://www.ginniemae.gov/newsroom/Pages/PressReleaseDispPage.aspx?ParamID=196.

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Laurie Goodman is a vice president at the Urban Institute and codirector of its Housing Finance Policy Center, which provides policymakers with data-driven analyses of housing finance policy issues that they can depend on for relevance, accuracy, and independence. Goodman spent 30 years as an analyst and research department manager on Wall Street. From 2008 to 2013, she was a senior managing director at Amherst Securities Group LP, a boutique broker-dealer specializing in securitized products, where her strategy effort became known for its analysis of housing policy issues. From 1993 to 2008, Goodman was head of global fixed income research and manager of US securitized products research at UBS and predecessor firms, which were ranked first by *Institutional Investor* for 11 years. Before that, she held research and portfolio management positions at several Wall Street firms. She began her career as a senior economist at the Federal Reserve Bank of New York. Goodman was inducted into the Fixed Income Analysts Hall of Fame in 2009. Goodman serves on the board of directors of MFA Financial, Arch Capital Group Ltd., and DBRS Inc. and is an adviser to Amherst Capital Management. She has published more than 200 journal articles and has coauthored and coedited five books. Goodman has a BA in mathematics from the University of Pennsylvania and an AM and PhD in economics from Stanford University.

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