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The Impact of Early Efforts to Clarify Mortgage Repurchases

Evidence from Freddie Mac and Fannie Mae's Newest Data

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The government-sponsored enterprises (GSEs) and their conservator, the Federal Housing Finance Agency (FHFA), have taken steps over the past two and a half years to give greater clarity to lenders about mortgage repurchase requests. These actions were motivated by the belief that lenders are not lending to the full extent of the credit box largely because they lack certainty about mortgage repurchase requests and that as a result mortgage credit remains too tight.

We use data released by the GSEs to examine the history of repurchase activity and determine if these efforts at clarity have had an impact. We find three significant changes that should lead to greater lender certainty.

1. **Earlier due diligence.** The GSEs are identifying loans with manufacturing defects much earlier in the process.
2. **Substantial cleanup of legacy loans.** Fannie Mae appears to have completed most of its repurchase requests for loans originated before 2009.
3. **Greater GSE consistency.** Freddie Mac and Fannie Mae's repurchase requests for post-2009 loans are now more consistent, though there is still room for improvement.

We first review the need for clarity and the specific actions taken over the past three years to address this concern. We then examine data newly released by the GSEs (to support their risk-sharing transactions) to determine the size and scope of the repurchase problem and to analyze the impact of the efforts toward clarity.

The Need for Clarity

Although mortgage lending in 2007 was too lax, today's lending has swung too far in the other direction. The Housing Finance Policy Center's credit availability index shows that the mortgage market could have taken twice the default risk it took in the first three quarters of 2014 and still remained well within the cautious standards of 2001–03.[1] As we have discussed extensively, this is largely because lenders are choosing not to lend to the full extent of the credit box allowed by the GSEs and the Federal Housing Administration (FHA).[2]

One key reason for lender reluctance is "put-back" uncertainty. Lenders are concerned that if a loan goes delinquent, then the FHA or the GSE taking the mortgage's credit risk will compel the lender to take the credit risk back. This put-back right is based on the representations and warranties (reps and warrants) that lenders provide in the original contract with the FHA or the GSEs.

Recognizing the concern about repurchase clarity, the FHA, the GSEs, and the FHFA introduced several policies beginning in September 2012 to assure lenders that a delinquent loan does not mean a put-back. The goal of these policies was to clarify that put-backs will be enforced for manufacturing defects only. In this paper we focus on the steps taken by the GSEs and FHFA.

Several policies introduced since September 2012 clarify that put-backs will be enforced for manufacturing defects only.

Actions to Increase Clarity

Announcements introducing rep and warrant sunsets: On September 11, 2012, the FHFA, Fannie Mae, and Freddie Mac each announced the launch of a new rep and warrant framework for loans sold or delivered on or after January 1, 2013. Under the new "rep and warrant relief" framework, sellers were relieved of certain repurchase obligations for loans that met specific pay history requirements. Rep and warrant relief was provided for loans with 36 months of consecutive, on-time payments. For Home Affordable Refinance Program loans, rep and warrant relief was provided for loans with 12 months of consecutive on-time payments.

These announcements further made clear that the GSEs would start reviewing loans earlier, primarily through a combination of random and targeted sampling. Fannie Mae's announcement stated the following:

> Lenders can expect an overall increase in the focus on reviewing performing loans selected prior to the 12- or 36-month sunset…When Fannie Mae reviews a mortgage loan file, it will evaluate the file with the primary focus of confirming that the mortgage loan meets underwriting and

eligibility requirements. In addition to selecting a random sample of new mortgage loan deliveries for review as it does today, Fannie Mae will employ a number of technology tools and internal models to identify earlier in the post-acquisition review process mortgage loans that may not meet Fannie Mae requirements and issues that may affect underwriting quality. If Fannie Mae determines that a loan failed to meet underwriting requirements or is otherwise ineligible, Fannie Mae may issue a repurchase request or pursue another remedy.[3]

Freddie Mac outlined a similar process in an industry letter of October 19, 2012:

> Under our core performing loans sample process and strategy, we select a random sample of new Mortgage deliveries that ensures statistical validity….The random sample is augmented with targeted samples for certain risk characteristics and/or Sellers, with a focus on loans that have indications of origination defects. A targeted sample is selected based on several factors, including the credit and collateral profiles of loans delivered by the Seller, Freddie Mac's projected performance of the loans delivered by the Seller, Freddie Mac's operational assessment of the Seller and, if applicable, the delivery volume of concentrated products.[4]

Relaxation of sunset eligibility requirements. In May 2014, in one of Director Watt's first actions, the FHFA relaxed the sunset eligibility requirements to allow loans with no more than two 30-day delinquencies and no 60-day delinquencies during the applicable 36- or 12-month period to qualify.

Clarifications of life-of-loan exclusions. In November 2014, the Watt FHFA put out detailed clarifications of the reps and warrants claims that would run with the life of the loan instead of being extinguished with the 36-month sunset.[5] These life-of-loan exclusions include (1) misrepresentations, misstatements, and omissions; (2) data inaccuracies; (3) charter compliance issues; (4) first-lien enforceability or clear title matters; (5) legal compliance violations; and (6) unacceptable mortgage products. The first two items received the most attention, as they was the focus of originator fears. A misstatement, for example, must involve at least three loans delivered to the GSE by the same lender, be "significant" and be made pursuant to a common activity involving the same individual or entity.

Repurchase Activity Analysis

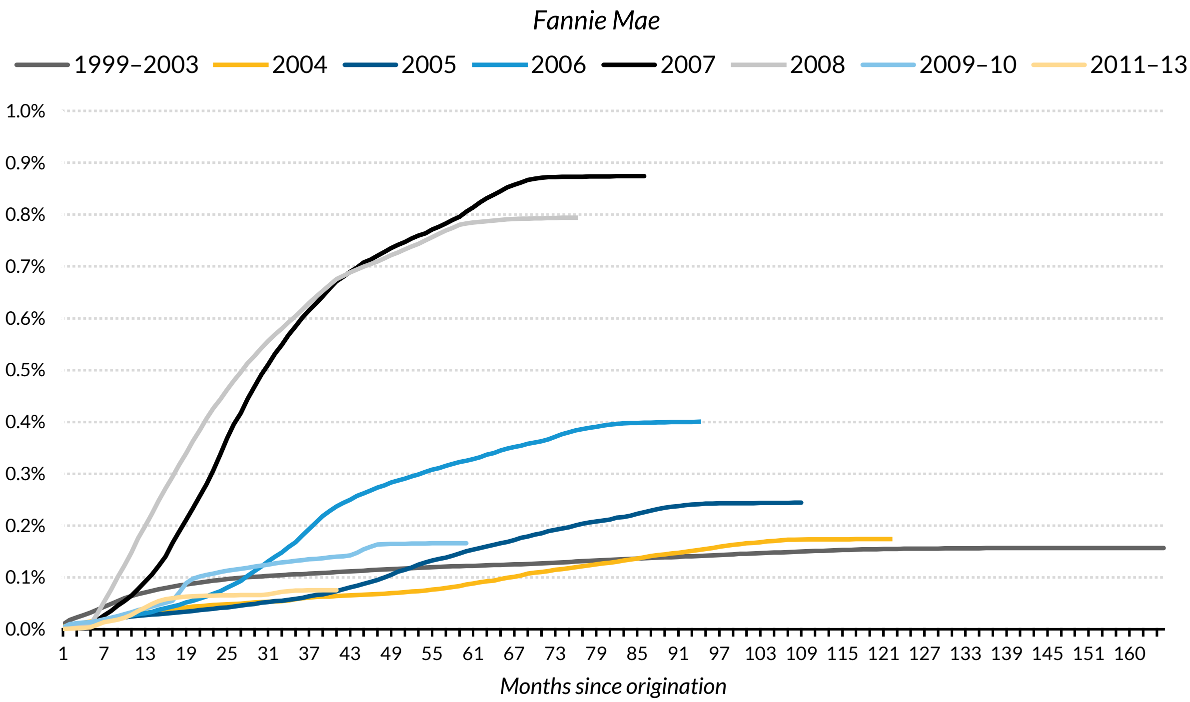
The loan-level credit data that Fannie and Freddie release in support of their Connecticut Avenue Securities and Structured Agency Credit Risk deals allow us to examine the overall scale of the repurchases on the 30-year fixed-rate, full-documentation, fully amortizing loans involved in the deals and evaluate the success of these initiatives.

Figure 1 shows the cumulative percentage of those loans in a given vintage that Fannie and Freddie have put back to lenders for rep and warrant violations. This percentage is calculated by measuring the balances that have been repurchased, compared with the balances originated in that vintage year.

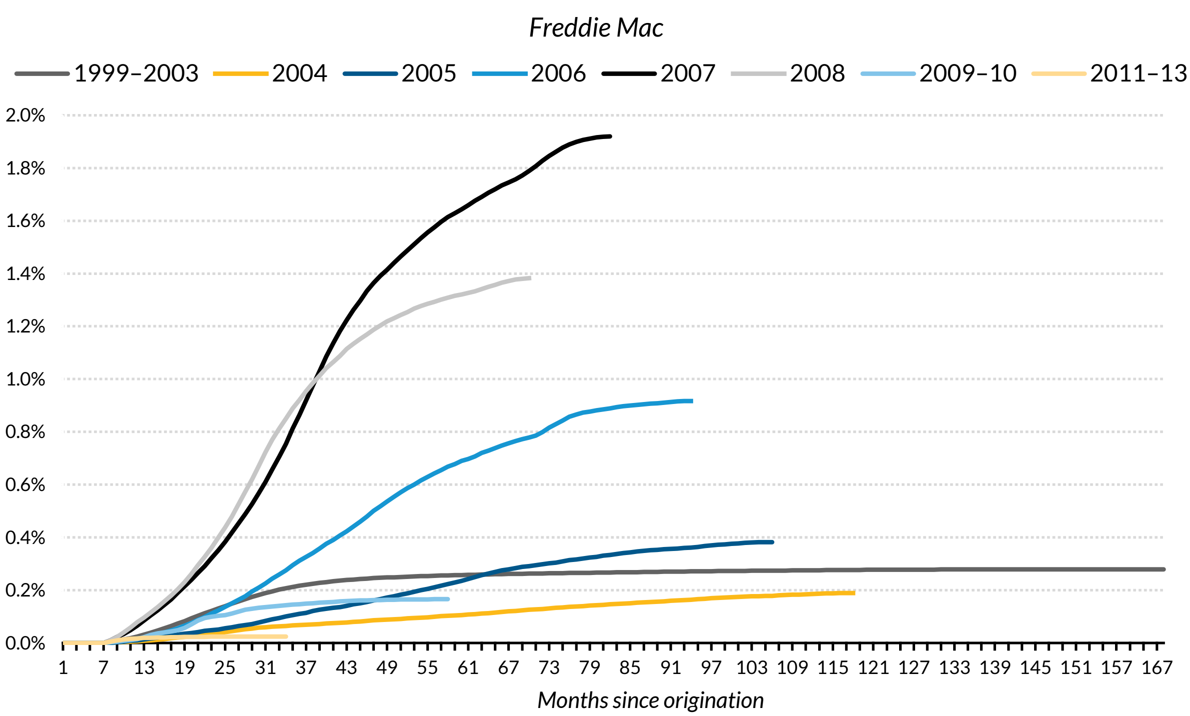
FIGURE 1

Repurchase Rates on 30-Year Fixed-Rate, Full-Documentation, Fully Amortizing Loans Have Been Modest

By origination year



Sources: Fannie Mae and Urban Institute.



Sources: Freddie Mac and Urban Institute.

This analysis reveals four interesting points.

Modest Repurchase Activity

Repurchases on 30-year fixed-rate, full-documentation, fully amortizing loans have been relatively small in most years, except from 2006 to 2008. The repurchase rate on the 1999–2003 vintages is 0.16 percent on Fannie Mae mortgages and 0.28 percent on Freddie Mac mortgages. Even the 2005 numbers are relatively muted: 0.24 percent for Fannie, 0.38 percent for Freddie. By contrast, the 2007 repurchase volume is an order of magnitude higher: 0.87 percent of total Fannie originations, 1.92 percent of total Freddie origination. We had noted this pattern in our earlier research (Goodman and Zhu 2013).

There are several caveats to this point, however.

First, we do not have a complete picture of all repurchase activity because both Fannie and Freddie numbers exclude the significant number of loans put back through global settlements, which are not done by loan. This dataset also does not include less-than-full-documentation loans and nontraditional products types such as interest-only and 40-year mortgages, which would have much higher put-back rates than the traditional, full-documentation 30-year product.

The GSEs could, at moderate cost, give lenders greater certainty on put-back conditions.

Second, the small number of repurchases shown here understates their impact on lenders. Lenders' attitudes are formed by the total share of put-backs on their books of business and by the reasons for those put-backs.

In any case, the numbers in figure 1 indicate that for most issue years, the put-back rates on full-documentation loans has been modest. This finding suggests that the GSEs could, at moderate cost, give lenders greater certainty as to the conditions under which a loan can be put back.

Historic Inconsistencies

Freddie Mac and Fannie Mae have not been aligned in their repurchase policies. According to our numbers, Fannie Mae has been less aggressive than Freddie Mac toward loans originated before 2009, with the differences largely converging for loans originated thereafter.[4] Again, there is a caveat: Fannie and Freddie report put-backs differently. Freddie reports loans put back after liquidation, and Fannie does not. Put-backs after liquidation (often called "make whole provisions") are a relatively small part of Freddie's put-backs, but a somewhat more important part of Fannie's put-backs.

More Up-Front Due Diligence

Though the new rep and warrant framework applies only to loans purchased in 2013 and later, the FHFA and the GSEs have clearly begun doing more up-front due diligence—that is, due diligence before loans have gone delinquent. As one would expect when due diligence occurs earlier in the process, the number of loans repurchased when they are current increases sharply. Table 1 shows the total number of loans repurchased, the number of loans that were current at the time of repurchase, and the number of loans that were "always current" at the time of repurchase. By the 2011 vintage, the percentage of loans repurchased when "always current" was over 90 percent for both GSEs.

TABLE 1

A Very High Percentage of Repurchases of More Recent Origination Are Current

		Always Current		Current at Repurchase	
Origination year	**Total repurchases**	**Number**	**%**	**Number**	**%**
		Fannie Mae			
1999	648	226	35	273	42
2000	3,514	1,503	43	1,820	52
2001	5,220	2,970	57	3,470	66
2002	4,807	2,699	56	2,995	62
2003	4,672	1,495	32	1,820	39
2004	2,381	577	24	730	31
2005	2,860	496	17	660	23
2006	3,345	364	11	552	17
2007	8,246	445	5	907	11
2008	8,621	863	10	1,491	17
2009	2,347	1,099	47	1,287	55
2010	2,839	2,584	94	2,668	98
2011	1,156	1,069	97	1,107	99
2012	877	794	90	835	95
2013	1,480	1,414	95	1,449	98
Total	**53,013**	**18,598**	**50**	**22,064**	**56**
		Freddie Mac			
1999	3,573	237	7	767	21
2000	4,259	263	6	828	19
2001	9,261	604	7	1,802	19
2002	7,870	894	11	1,602	20
2003	3,076	834	27	1,068	35
2004	2,709	516	19	698	26
2005	5,143	520	10	889	17
2006	9,601	617	6	1,571	16
2007	19,310	882	5	3,326	17
2008	12,889	652	5	2,859	22
2009	3,664	2,092	57	2,478	68
2010	840	599	71	675	80
2011	589	545	93	571	97
2012	415	399	96	408	98
2013	180	179	99	179	99
Total	**83,379**	**9,833**	**12**	**19,721**	**24**

Sources: Fannie Mae, Freddie Mac, and Urban Institute.

The FHFA and the GSEs have begun doing more up-front due diligence.

Substantial Cleanup of Legacy Loans

Table 2 shows a few notable trends in repurchase activity by year of origination and year of repurchase. First, both Fannie and Freddie pursued repurchases most aggressively in 2009–11, focusing on loans originated before 2009. Second, Director DeMarco's end-of-2013 deadline to file any repurchase claims on loans originated before 2009 shaped Fannie and Freddie's behavior. We can see from the data that Fannie repurchased very few legacy loans in 2014: only 126 of all loans issued from 2000 to 2009. (Freddie performance data do not extend into 2014.) That same year, Fannie repurchased 609 loans issued in 2010, 464 issued in 2011, 342 issued in 2012, and 1,274 issued in 2013. Third, Fannie Mae is clearly performing early due diligence, as shown by the number of 2013 loans put back in 2014.

TABLE 2

Total Loans Repurchased by Origination and Repurchase Years

Orig. year/ Rep. year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
									Fannie Mae								
1999		163	126	131	74	45	28	25	17	9	7	16	7	.	.	.	648
2000		321	1,072	1,004	345	228	160	114	79	37	47	45	31	26	5	.	3,514
2001		.	603	2,470	802	381	223	246	108	65	110	57	72	68	13	2	5,220
2002		.	.	1,391	1,177	480	342	453	121	109	219	162	147	185	14	7	4,807
2003		.	.	.	556	721	573	518	253	215	516	382	427	459	40	12	4,672
2004		.	.	.	.	194	417	178	199	155	305	295	293	313	19	13	2,381
2005		.	.	.	.	.	170	283	243	280	561	443	412	413	41	14	2,860
2006		.	.	.	.	.	.	117	291	509	1,043	507	374	446	45	13	3,345
2007		.	.	.	.	.	.	.	168	1,086	2,945	1,922	933	1,054	123	15	8,246
2008		.	.	.	.	.	.	.	.	398	3,030	2,384	1,487	1,021	273	28	8,621
2009		.	.	.	.	.	.	.	.	.	295	702	722	491	115	22	2,347
2010		.	.	.	.	.	.	.	.	.	.	260	399	1,472	99	609	2,839
2011		.	.	.	.	.	.	.	.	.	.	.	77	433	182	464	1,156
2012		.	.	.	.	.	.	.	.	.	.	.	.	90	445	342	877
2013		.	.	.	.	.	.	.	.	.	.	.	.	.	206	1,274	1,480
Total		**484**	**1,801**	**4,996**	**2,954**	**2,049**	**1,913**	**1,934**	**1,479**	**2,863**	**9,078**	**7,175**	**5,381**	**6,471**	**1,620**	**2,815**	**53,013**
									Freddie Mac								
1999	109	593	1,189	835	446	234	25	20	15	19	20	27	23	14	4		3,573
2000	.	102	837	1,448	1,206	458	74	21	17	16	22	20	25	9	4		4,259
2001	.	.	160	1,916	3,856	2,409	370	100	91	85	83	73	79	27	12		9,261
2002	.	.	.	329	2,780	2,899	784	336	167	183	123	110	86	54	19		7,870
2003	.	.	.	.	234	763	523	440	196	267	195	180	151	74	53		3,076
2004	.	.	.	.	.	163	299	541	272	252	259	305	219	230	169		2,709
2005	.	.	.	.	.	.	64	469	593	812	788	988	594	482	353		5,143
2006	.	.	.	.	.	.	.	108	590	1,496	2,007	2,195	1,333	1,212	660		9,601
2007	.	.	.	.	.	.	.	.	182	1,639	3,563	6,092	3,503	2,370	1,961		19,310
2008	.	.	.	.	.	.	.	.	.	266	2,061	4,430	3,465	1,711	956		12,889
2009	.	.	.	.	.	.	.	.	.	.	167	951	1,734	611	201		3664
2010	.	.	.	.	.	.	.	.	.	.	.	143	307	324	66		840
2011	.	.	.	.	.	.	.	.	.	.	.	.	174	362	53		589
2012	.	.	.	.	.	.	.	.	.	.	.	.	.	163	252		415
2013	.	.	.	.	.	.	.	.	.	.	.	.	.	.	180		180
Total	**109**	**695**	**2,186**	**4,528**	**8,522**	**6,926**	**2,139**	**2,035**	**2,123**	**5,035**	**9,288**	**15,514**	**11,693**	**7,643**	**4,943**		**83,379**

Sources: Fannie Mae, Freddie Mac and Urban Institute.

Conclusion

The new Freddie Mac and Fannie Mae credit data provide significant transparency into GSE put-backs. The data show a shift toward earlier detection of rep and warrant violations, with many more put-backs on current loans; that DeMarco's request to clean up legacy loans by the end of 2013 had an impact, at least in Fannie Mae's case; and that Freddie Mac has been much more aggressive in putting back loans originated before 2009. With both GSEs emphasizing early detection, the differences on post-crises loans are small.

The shift toward earlier detection allows for feedback at a much earlier stage in the process, and hence greater lender certainty. Think of it this way: students walking into a final exam are much clearer about the professor's expectations if they have received grades on homework and midterms throughout the semester. Here the objective is to ensure that lenders aren't walking into their exam blind.

The ultimate in lender certainty would be detection of manufacturing defects at the point of origination, giving the lenders room to correct. Freddie Mac and Fannie Mae are both moving in the direction of providing more feedback at the point of origination, most critically on appraisals. We would hope that over time, the detection systems are improved to the point that some reps and warranties can be completely waived at the point of origination. For example, if the appraisal is within a certain percentage of the value computed by the GSEs' automated system, the GSEs should be able to assure lenders that they have no further liability.

We are greatly encouraged by the FHFA's and the GSEs' progress in narrowing lender liability to manufacturing defects, and we are hopeful that this will begin to open up the credit box in GSE lending. If they can continue to pull forward their detection of mistakes, then we would expect still more progress and still broader access to credit to follow.

Notes

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3. Fannie Mae, "New Lender Selling Representations and Warranties Framework," MBS News and Announcements, September 11, 2012.
4. Freddie Mac, "Subject: Quality Control and Enforcement Practices," industry letter to Freddie Mac sellers and servicers, October 19, 2012.
5. Fannie Mae, "Lender Selling Representations and Warranties Framework Updates," *Selling Guide* Announcement SEL-2014-14, November 20, 2014.
6. We have Fannie data through Q3 2014, while Freddie data are available only through year-end 2013.

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Before joining Urban in 2013, Goodman spent 30 years as an analyst and research department manager at a number of Wall Street firms. 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 was ranked first by *Institutional Investor* for 11 straight years. She has also held positions as a senior fixed income analyst, a mortgage portfolio manager, and a senior economist at the Federal Reserve Bank of New York.

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Jim Parrott is a senior fellow with the Housing Finance Policy Center at the Urban Institute, where he ensures that the analytic work being done plays a role in the major policy discussions of the day, giving Urban a seat at the table with leaders and stakeholders working to shape the future of the nation's housing policy.

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