

## Fannie Fees Fail to Offset Record Low Lending Rates: Mortgages

By Jody Shenn and John Gittelsohn - Jan 18, 2012

[Ben S. Bernanke](#)'s success in pushing [mortgage rates](#) to record lows is enabling Congress to fund last month's payroll tax cut extension by siphoning money from Fannie Mae and [Freddie Mac \(FMCC\)](#), while homebuyers still benefit from the cheapest borrowing costs in history.

The legislation mandated that Fannie Mae, Freddie Mac and the [Federal Housing Administration](#) charge more to guarantee [home-loan debt](#), starting with an increase of 0.1 percentage point at Fannie Mae and Freddie Mac in April. It will force further increases of as much as 0.45 percentage point over the next two years at the two U.S.-supported companies, according to Nomura Securities.

Increases of twice that amount would leave 30-year home- loan rates at levels unseen before 2009 after Federal Reserve Chairman Bernanke kept the short-term [lending benchmark](#) near zero and bought \$1.25 trillion of mortgage bonds. The greater fees suggest that Congress and President Barack Obama's administration are willing to bet the housing recovery is far enough along to withstand the rise.

"Rates are so low right now, that additional cost is marginal, said [Mark Goldman](#), a mortgage broker at C2 Financial Corp. in [San Diego](#). "The only impact it will have is on people who have a visceral reaction to being singled out to fund the extension of the payroll tax cut."

The [average rate](#) on a typical 30-year mortgage fell last week to a record low 3.89 percent, according to surveys by McLean, Virginia-based Freddie Mac. The average over the past decade has been 5.69 percent, with the high in the period of 7.18 percent reached in 2002 as [home prices](#) were rising.

## Buffett Recovery

[Warren Buffett](#), the billionaire chairman and chief executive officer of [Berkshire Hathaway Inc. \(BRK/A\)](#), has said that housing will recover from its [six-year slump](#).

"We're creating more households every day than we are houses and we will come into balance," he told [Charlie Rose](#) in a September interview.

[JPMorgan Chase & Co. \(JPM\)](#) Chief Executive Officer [Jamie Dimon](#), whose bank is the second-largest U.S. mortgage lender, told investors and analysts in a conference call on Jan. 13 that housing is "getting closer" to a bottom.

“We’re going to add 3 million Americans every year for the next 10 years, that’s 30 million Americans who need 13 million dwellings,” Dimon said. “Mortgage underwriting will loosen, not tighten. If you put all those things together, you’re going to have a turn at one point.”

## Mortgage Applications Jump

Falling rates and property prices pushed housing [affordability](#) to a record high last year, according to a National Association of Realtors index. The gauge showed in the third quarter, the most recent available, that households with the U.S. median income earned 184 percent of the money needed to qualify for a mortgage to buy a house.

Mortgage [applications](#) in the U.S. jumped last week as low borrowing costs spurred purchases and refinancing. The [Mortgage Bankers Association](#)’s index rose 23 percent in the period ended Jan. 13 after rising 4.5 percent in the prior week, the Washington-based group reported today. The group’s measure of [purchases](#) increased 10 percent, while the [refinancing](#) index surged 26 percent to the highest level since August.

A “more rapid recovery” is being prevented by policy makers failing to coordinate, he said. “There is no one really in charge of all this,” Dimon said on the call.

An increase of 55 basis points, or 0.55 percentage point, in guarantee fees at Fannie Mae and [Freddie Mac](#), known as government sponsored enterprises, or GSEs, would raise the cost of a new \$300,000 30-year mortgage by about \$1,200 a year, assuming current loan rates as the base level and that the amount was fully passed on to borrowers.

## Homeowner Tax

“The increase in GSE fees is nothing short of a new homeowner tax,” said John Robbins, a former chairman of the Mortgage Bankers Association who’s starting Bexil American Mortgage Inc. in San Diego. It’s “unbelievable” that “our legislators and regulators propose real-estate stimulus out of one side of their mouths and raise costs out of the other.”

[Interest rates](#) aren’t the biggest obstacle to a housing recovery, said Sung Won Sohn, professor of economics at [California State University Channel Islands](#) and a former chief economist at [Wells Fargo & Co. \(WFC\)](#)

“I don’t know anybody who can’t buy or finance a home because interest rates are too high,” Sohn said in a telephone interview from Ventura, California. “The cost of borrowing should reflect the amount of risk you’re taking. Fannie and Freddie ran into trouble in the past because they didn’t price their risk effectively.”

## Government Approach Shifts

The decision to use revenue from Fannie Mae and Freddie Mac to fund the payroll tax extension, represents a shift in the government's approach to Fannie Mae, said analysts at RBS Securities led by Margaret Kerins. The legislation says that the guarantee fees, known as g-fees, charged by the companies "shall be increased to reflect the risk of loss, as well as the cost of capital allocated to similar assets held by other fully private regulated financial institutions."

The higher fees must be used to pay the government until October 2021, complicating any future effort to wind down the companies, which have cost taxpayers more than \$153 billion since being seized by the U.S. in 2008. Directing revenue from the enterprises to the [U.S. Treasury](#) "utilizes the GSEs in a way we have not really seen before, bringing them closer to the government," the RBS analysts wrote.

The FHA, the U.S. agency that's continued to insure loans with down payments as low as 3.5 percent, also must raise its premiums by 0.1 percentage point, or 10 basis points, in the next two years under the law, which extended the payroll tax relief for two months.

## Cross Purposes

That some government mortgage policies are working at cross purposes was highlighted in a Jan. 13 report by Barclays Capital analysts led by Ajay Rajadhyaksha.

In one section of the report, they said a decision by lawmakers to allow homeowner tax breaks for mortgage-insurance payments to lapse on Dec. 31 may further reduce [refinancing](#) among FHA loans that was already depressed by separate administration moves.

At the same time, regulators have in recent weeks improved the effectiveness of the Home Affordable Refinance Program, or HARP, for [Fannie Mae](#) and Freddie Mac borrowers with little or no home equity, the analysts wrote, exceeding their initial expectations for the expansion.

Fannie Mae and Freddie Mac last month reduced the one-time fees they charge for riskier borrowers under HARP adjustments that also include cutting lender risks.

## Bernanke Study

Bernanke underscored the importance of housing to the broader economy when he sent Congress a [study](#) by his staff on Jan. 4 laying out a range of proposals for lawmakers or the Obama administration to consider, from steps that could further loosen lending standards to programs for turning foreclosed homes into rental properties.

The Fed has helped restrain borrowing costs by holding its benchmark for short-term rates near zero, and with a program in which it may buy about \$200 billion of government-backed mortgage bonds this year by reinvesting proceeds from previous purchases, or more than 20 percent of new loans, estimates compiled by Bloomberg show.

Still, an [S&P/Case-Shiller index](#) of property values in 20 cities dropped 3.4 percent in the year through October, bringing declines since the 2006 peak to 32 percent. Existing home sales remain about 20 percent below their 10-year average, while New York Fed President William Dudley estimates that properties [seized by lenders](#) may rise to 1.8 million this year and the same number next year, from about 1.1 million last year.

## Reducing Government Role

Fannie Mae, Freddie Mac, the FHA and other government agencies help finance about 90 percent of new mortgages, according to newsletter Inside Mortgage Finance. Fannie Mae's g- fees for new business averaged 29 basis points in the first nine months of last year, according to a [filing with the U.S. Securities and Exchange Commission](#).

Edward DeMarco, acting director of the [Federal Housing Finance Agency](#), had already said in a September speech that he planned to increase the fees, following up on the Obama administration's paper last February that described the step as an interim measure that could reduce the government's role in the mortgage market.

In a comment made in December before Congress approved the fee, DeMarco said relying on long-term revenue from the companies for short-term tax cuts "seems inconsistent with the need to end the conservatorships and reform our housing-finance system." The agency "will implement whatever Congress directs," DeMarco said at the time.

## Reducing GSE Role

Future increases at Fannie Mae and Freddie Mac after their April 1 rises probably will range between 15 basis points and 45 basis points over the next two years, the New York-based Nomura analysts Ankur Mehta, Dhivya Krishna and Ohmsatya Ravi wrote in a Jan. 13 note to clients. The exact amount is "subject to interpretation," they said.

If fees increase by about 75 basis points to 100 basis points that would reduce Fannie Mae and Freddie Mac's role in the market because banks may opt to keep the loans on their balance sheets, JPMorgan analysts led by Matt Jozoff said in a Jan. 6 report.

Since the initial details of the HARP expansion were released in November, Fannie Mae has removed language in its guidelines referencing a borrower's "ability to repay" the loan. Analysts at Barclays said this would help assure lenders they won't need to buy back soured debt for underwriting errors.

## Loosened Standards

Freddie Mac loosened standards in its streamlined refinancing program for borrowers with loan-to-value ratios of less than 80 percent, which Bernanke's paper cited as a barrier to refinancing. It removed a restriction that blocked refinancing of loans it already guarantees if homeowners are

underwater because of second-lien home equity debt, and ended a requirement that the borrowers have credit scores of at least 620.

The expiration of mortgage-insurance tax deductions, which covered homeowners with less than \$109,000 in income and loans taken after 2007, will hit FHA borrowers, potentially costing someone with a \$200,000 loan almost \$500 annually, according to the Barclays analysts.

It also reduces incentives to refinance, because of previous fee increases by the agency, the New York-based analysts said. The FHA boosted its annual premiums in two steps starting in October 2010, to as much as 1.15 percent from 0.55 percent.

## Capital Ratios

Borrowers paying the previous premium can't maintain it on a new loan. It's possible the agency could allow a grandfathering of borrowers' existing premiums by saying doing so would reduce defaults, according to JPMorgan analysts. Brian Sullivan, a FHA spokesman, declined to comment.

The agency's capital ratio fell last year to 0.24 percent from 0.5 percent in the prior fiscal year. The FHA has failed to meet the legal minimum 2 percent ratio for three straight years after expanding as private lenders retreated.

FHA Acting Commissioner Carol Galante has [said](#) that her agency will consider raising its premiums, an additional cost for borrowers, to avoid a taxpayer bailout if housing worsens. "We continue to keep our options on the table," she said in a November letter to Congress.

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