State-Level Guarantee Fee Analysis

Due to differences in state laws and practices that govern mortgage foreclosures, there are sizable differences among the states in the average length of time it takes to complete the foreclosure process. State-level differences in foreclosure timelines have increased since the start of the recent downturn in the housing market. A recent study that compared the 2005-January 2007 and the February-September 2012 periods found that the average time between the date of the last payment on a delinquent mortgage and the sale of the property following foreclosure rose from 27 to 44 months in states with a judicial foreclosure process and from 16 to 22 months in states with a statutory process. That study also predicted that foreclosure timelines will continue to lengthen in the near term as the current backlog of delinquent mortgages complete the foreclosure process.[1]

Growing differences in state-level foreclosure timelines have led to greater concentration in a few states of single-family mortgages that have been delinquent for extended periods. For example, at year-end 2012, loans financed by Fannie Mae and Freddie Mac (the Enterprises) that have been delinquent one year or more were concentrated in a few states. Mortgages in Florida, for example, made up 6 percent (based on unpaid principal balance) of the Enterprises' combined book of business at year-end 2012 but accounted for nearly 28 percent of loans delinquent one year or more (Table 1). The three states with the largest shares of mortgages delinquent one year or more accounted for 15 percent of the Enterprises' combined book of business but nearly half of delinquencies at least one year old.

During the foreclosure process, the investor in a delinquent mortgage must pay for all expenses related to the property, including taxes and maintenance, legal expenses related to the foreclosure, and the cost of financing a non-earning asset. Differences by state in the total of those carrying costs incurred by investors during the foreclosure process have risen in recent years as state-level differences in foreclosure timelines have increased. As the largest mortgage investors in the country, the Enterprises have incurred significantly greater total carrying costs

[1] Cordell, L., L. Geng, L. Goodman, and L. Yang, "The Cost of Delay," Working Paper Number 13-15, Federal Reserve Bank of Philadelphia, April 2013.

due to the lengthening of foreclosure timelines in recent years. The Enterprises' costs have generally risen most in states whose foreclosure timelines have increased the most.

Table 1
States Ranked by Percent of Total Enterprise Delinqencies Over One Year Old

State	Percent of Total Enterprise Delinquencies Over One Year Old (Year End 2012)	Percent of Total Loans Acquired by Enterprises in 2012	State	Percent of Total Enterprise Delinquencies Over One Year Old (Year End 2012)	Percent of Total Loans Acquired by Enterprises in 2012
FL	27.8%	6.0%	LA	0.4%	0.8%
NY	11.0%	5.4%	RI	0.4%	0.4%
NJ	10.3%	3.9%	KY	0.4%	0.7%
CA	6.6%	17.7%	DE	0.4%	0.4%
IL	6.6%	4.6%	TN	0.3%	1.3%
MD	4.2%	2.9%	ID	0.3%	0.5%
WA	3.4%	3.5%	AL	0.3%	1.0%
PA	2.6%	3.1%	DC	0.3%	0.4%
NV	2.5%	1.0%	MO	0.3%	1.5%
MA	2.2%	3.0%	AR	0.3%	0.5%
CT	1.7%	1.4%	OK	0.3%	0.6%
OH	1.6%	2.5%	PR	0.3%	0.3%
OR	1.6%	1.7%	IA	0.3%	0.7%
NC	1.3%	2.7%	NH	0.2%	0.5%
SC	1.2%	1.3%	VT	0.2%	0.2%
GA	1.2%	2.8%	MS	0.2%	0.4%
TX	1.1%	5.0%	KS	0.2%	0.6%
HI	1.1%	0.8%	MT	0.1%	0.3%
IN	0.9%	1.4%	NE	0.1%	0.4%
VA	0.9%	3.6%	WV	0.1%	0.2%
AZ	0.9%	2.4%	SD	0.0%	0.2%
WI	0.7%	1.8%	AK	0.0%	0.2%
MI	0.7%	2.6%	VI	0.0%	0.0%
NM	0.6%	0.5%	WY	0.0%	0.2%
ME	0.5%	0.3%	ND	0.0%	0.1%
UT	0.5%	1.1%	GU	0.0%	0.0%
CO	0.5%	2.5%	Total	100.0%	100.0%
MN	0.5%	2.2%	Top 3 States	49.1%	15.2%

Source: FHFA

In September 2012, the Federal Housing Finance Agency (FHFA) published a Notice in the Federal Register[2] detailing an approach by which the Enterprises would charge higher loan guarantee fees on mortgages originated in five states where they have experienced extraordinarily high total carrying costs from loan defaults as a result of state laws and practices that draw out the foreclosure process. Because the Enterprises currently charge the same guarantee fees nationwide, borrowers in lower-cost states have to pay more to subsidize borrowers in higher-cost states. These costs on defaulted loans are also borne in part by taxpayers through federal support for the Enterprises. To address that situation, FHFA's Notice proposed to charge additional, upfront guarantee fees of between 15 and 30 basis points[3] on mortgages acquired by the Enterprises that were originated in the five highest-cost states: New York, New Jersey, Connecticut, Florida, and Illinois. Those five states each posed costs more than one and one half standard deviations above the national average. The proposed increases would have added approximately $3.50 to $7.00 to the monthly payment on a 30-year, fixed-rate mortgage of $200,000, at then current interest rates, and would only have applied to newly acquired mortgages.

FHFA solicited and received extensive public input on the approach and has carefully considered that input, but has found the arguments made therein not to be sufficient to require fundamental change to the approach. FHFA did, however, determine that the fee structure proposed in the Notice could be considerably simplified, which would facilitate implementation and focus the effort more directly on the states that are the most extreme outliers in terms of high carrying costs. In addition, FHFA has revised its analysis to reflect more recent data and developed a schedule for implementation of the new guarantee fees.

Under the revised approach, mortgages newly acquired by the Enterprises that were originated in states that have expected carrying costs more than two standard deviations above the national average, New York, New Jersey, Connecticut, and Florida, will be charged an additional upfront guarantee fee of 25 basis points. The prior approach published in the September 2012 Notice had charged fees to all states over one standard deviation. Under the revised approach, Illinois will

[2] www.fhfa.gov/SupervisionRegulation/Rules/Pages/StateLevel-Guarantee-Fee-Pricing.aspx.
[3] A basis point is 1/100 of one percent.

not be charged a fee, as it does not exceed the new threshold. The 25 basis point fee closely approximates the marginal cost to the Enterprises in those four states in excess of the national average (mean) carrying cost. Collectively, mortgages originated in those four states represented more than 16.7 percent of the Enterprises' single-family loan acquisitions during 2012. The new fees will take effect for mortgages acquired by the Enterprises on or after April 1, 2014. FHFA anticipates updating this analysis on an annual basis and making appropriate adjustments to reflect updated data and better measurement of default-related carrying costs.

The remainder of this document explains the problem of state foreclosure carrying cost disparities, reviews the approach set forth in FHFA's September 2012 Notice, discusses the public input received and FHFA's evaluation of the various arguments and suggestions, describes FHFA's updated data and methodology, and lays out FHFA's plan for implementation.

1.) The Problem of State Carrying Cost Disparities

Since September 2008, the government-sponsored enterprises Fannie Mae and Freddie Mac have been under the conservatorship of FHFA. As conservator, FHFA is charged with conserving and preserving the Enterprises' assets and minimizing the costs that the Enterprises impose on American taxpayers. In recent years, the losses sustained by the Enterprises as a result of carrying defaulted mortgages on their books have increased dramatically. That increase is in large part the result of the unusually long time it takes in certain states to complete the foreclosure process and associated post-foreclosure requirements. During that time, the borrower is not paying his or her mortgage, yet for legal or procedural reasons, the property backing the loan cannot be sold to recover the Enterprises' lost revenue.

Since mortgage defaults began to increase in 2007, lawmakers in many states have imposed additional legal requirements on servicers and their representatives in cases of loan default. Those requirements vary by state, but may include required meetings between servicers and borrowers, lengthy periods for borrowers to answer a summons, or mandatory waiting periods before filing a default judgment. Those delays are particularly severe in judicial foreclosure states. Some states have also instituted redemption periods after the foreclosure during which the defaulted borrower can buy back their former home. Further, in certain states it takes additional time for the investor to evict a former homeowner or tenant after the foreclosure sale if the occupant does not vacate the property voluntarily. Those post-foreclosure delays add to the time that the property cannot in practice be marketed for sale, even if the investor has a clear title.

In addition, there are lengthy delays from backlogs in the foreclosure processing infrastructure in certain states. Although backlogs are not a direct result of state legal requirements, they are the result of the foreclosure process that policy makers in the state have chosen to implement and the resources they have appropriated to fund that process.

FHFA believes that new state laws and other changes in foreclosure practices in recent years were made with the best of intentions, yet they have not been without costs. Those costs are borne by the mortgage investor, who incurs expenses during the foreclosure process for property taxes, insurance, legal fees, property maintenance, and capital funding. At present, the American taxpayer is the largest investor in single-family mortgages, through the U.S. Department of the Treasury's financial support of the Enterprises and through extensive Federal Reserve purchases of mortgage-backed securities. Because Enterprise profits and losses directly affect payments received by the Treasury pursuant to each Enterprise's Senior Preferred Stock Purchase Agreement with the Treasury, taxpayers bear the costs to the Enterprises of carrying defaulted mortgages on their books for longer periods.

The time it takes to complete a foreclosure from the last paid installment on the mortgage to the point where the investor has a marketable title to a vacant property varies tremendously by state. Based on the foreclosure timelines FHFA used in formulating this approach, detailed further below, that period ranges from 240 days in the cases of Missouri and Alabama to as much as 850 days in the case of New York. That is a range of 610 days, with a national weighted average of 438 days. Foreclosure timelines for all states, Washington, D.C., and select territories (referred to as "states" in this document for simplicity) can be seen in Table 2 in Section 4.

The Enterprises traditionally have charged similar guarantee fees nationwide for securitizing single-family mortgages with similar characteristics. Those fees are intended to cover all costs associated with the guarantees. Because the states with long foreclosure timelines impose much greater total carrying costs in cases of default than do other states, this system has become increasingly unfair to borrowers who do not live in the high-cost states. Borrowers in states with lower total carrying costs are paying more than they should, based on the expected default losses from their loans, while those in the high-cost states are paying less. By failing to establish risk-based pricing for those costs, the current approach produces a form of cross subsidization in guarantee fee pricing, which FHFA has generally sought to eliminate during the Enterprise conservatorships in an effort to align guarantee fees more closely with costs.[4] Because of the risk of increased taxpayer losses, and because the current guarantee fee pricing structure is inherently unfair to borrowers in many states, FHFA has worked to develop a process to recover a portion of the greater costs the Enterprises incur in states with higher total carrying costs.

2.) September 2012 Federal Register Notice

On September 25, 2012, FHFA published Federal Register Notice No. 2012-N-13, which outlined an approach to increasing the upfront fees that Fannie Mae and Freddie Mac charge to guarantee single-family mortgages in five states: New York, New Jersey, Connecticut, Florida, and Illinois. The Notice laid out the rationale for this change, explained the methodology behind it, and requested public input on FHFA's approach.

In formulating the approach, FHFA first requested that each Enterprise produce an estimate of the total carrying costs of defaulted loans that go through foreclosure in each state. Those estimates relied on three key variables. The first was the foreclosure timeline: the number of days from last paid installment on the mortgage to the point at which the investor has obtained a marketable title to the foreclosed property (known as "real estate owned" or "REO"). The foreclosure timelines in turn had two components: the Servicing Alignment Initiative (SAI) timelines published by the Enterprises in June 2012, which cover the period between the last paid

[4] 125 Stat. 1280, Public Law 112–78—Dec. 23, 2011, Temporary Payroll Tax Cut Continuation Act Of 2011, Section 401 (c)(1)(B).

installment and the foreclosure date when the investor takes ownership of the property; and, in some states, an Unable to Market (UTM) period that provides for any post-foreclosure delays such as redemption periods that prevent the investor from disposing of the property. The SAI timelines, which FHFA has worked with the Enterprises to develop for the purpose of evaluating the performance of servicers, are discussed further in the following section on Public Input.

The second variable was an index of the cost per day, adjusted for loan size, to the investor to hold the mortgage during the foreclosure process, estimated using 2011 data. That cost included property taxes, hazard insurance, property deterioration and maintenance costs, legal costs, and funding costs. For the September 2012 Notice, FHFA calculated an index on a state-by-state basis, where the national average cost was set at 100 and each state's index value was equal to the ratio of that state's costs to the national average. That index ranged from a low of 68 in Puerto Rico to a high of 132 in Texas, where costs are particularly high largely due to property taxes in that state. The cost per day, in units of basis points of UPB (i.e., unindexed) is shown in Table 2 in Section 4.

The final variable was an expected national default and foreclosure rate estimated using 2011 data. A national rate was used rather than individual state rates to eliminate the influence of state housing markets and isolate the effects of state law and practice. Default rates are discussed further in the Public Input section.

From those data, each Enterprise created a schedule of upfront fees or credits that would remove cross-subsidies among borrowers in different states, assuming loan acquisitions in the future were similar to past experience. FHFA combined the individual Enterprise schedules using a weighting of 60 percent for Fannie Mae and 40 percent for Freddie Mac, which closely approximates the relative levels of the Enterprises' loan acquisitions in recent years. That calculation yielded a combined schedule of fees and credits.

FHFA then calculated standard deviations from the mean of the combined schedule. States more than one positive standard deviation from the mean on the combined schedule were considered to be statistical outliers. FHFA proposed in the Notice that such states would be charged an additional fee. The state between one and one half and two standard deviations from the mean—Illinois—would have an upfront fee of 15 basis points. The states between two and three standard deviations from the mean—Florida, Connecticut, and New Jersey—would have an upfront fee of 20 basis points. The state more than three standard deviations from the mean—New York—would have an upfront fee of 30 basis points.

Those fees would be charged to lenders as a one-time upfront payment on each new loan acquired by the Enterprises. Lenders may pass an upfront fee through to a borrower as an adjustment to the interest rate. Because the upfront fee is paid only once, its impact on the annual interest rate is much smaller than the upfront fee itself. Dividing the upfront fee by five provides an approximation of the potential impact on the interest rate. To illustrate, a 15 basis point upfront fee, if fully passed through by the lender, would be roughly equivalent to an increase in the annual interest rate of three basis points. Under the approach outlined by FHFA in the Notice, a homeowner in an affected state obtaining a 30-year, fixed-rate mortgage of $200,000 would have seen an increase of approximately $3.50 to $7.00 in his or her monthly mortgage payment, reflecting a range of upfront fee adjustments of 15 to 30 basis points. Those fee adjustments would have only applied to new single-family loans acquired by the Enterprises, not to existing loans.

3.) Public Input

FHFA received 60 letters in response to the Notice from state and local elected officials, mortgage industry groups and lenders, housing advocacy organizations, and private citizens. Many of the responses came from individuals or groups in the five states that would receive fee increases as described in the Notice. Most responses opposed the imposition of state-level guarantee fee increases.

As mentioned earlier, however, the differences in foreclosure carrying costs between states represent incomplete risk-based pricing and are a major source of cross subsidization between borrowers. FHFA policy since the start of the conservatorship has been to reduce or eliminate sources of cross subsidization, which are fundamentally unfair to borrowers and distort the riskreturn balance in the mortgage market. This policy is also consistent with statute, as noted in footnote four.

Individual letters in the public input frequently made several arguments that were often similar to but subtly different from arguments in other letters. The subsections below explain some of the most common arguments put forth and FHFA's assessment of the theoretical validity and practical feasibility of modifying the approach to respond to the arguments.

Timelines

FHFA paid particularly close attention to the argument that the SAI timelines used in its approach were not appropriate for this use. In that view, state laws and practices are not the primary drivers of delays in states with long foreclosure timelines, which makes the SAI timelines an inappropriate standard. It was also argued that although many states have imposed new legal requirements, the time periods necessary to comply with them are typically much shorter than the SAI timelines.

In order to evaluate these claims, it is useful to understand the SAI timelines themselves. Those timelines are adjusted averages of actual foreclosure experience and, thus, reflect many factors other than minimum legal requirements, including servicer processing backlogs, servicer or attorney misconduct, court and other government backlogs, and borrower-caused delays (e.g., contesting foreclosure or missing hearings). The timelines are jointly developed by the Enterprises to provide a realistic standard in each state for evaluating servicer performance. While the SAI timelines do reflect sources of delay other than state laws, the impact of those sources varies among states and is difficult to separate clearly from the impact of state law. An alternative set of state foreclosure timelines that FHFA considered are those of the United States Foreclosure Network (USFN), which are intended to be used by foreclosure attorneys for reference purposes. The USFN states that its timelines:

> … are optimum and assume no delays. They are based upon uncontested foreclosure actions that are referred with all necessary documents (and with all

necessary assignments previously recorded) and conducted under GSE guidelines. Accordingly, timelines will vary from case to case depending on loan type and the particular circumstances.[5]

Because those circumstances rarely occur in practice, actual foreclosures typically take considerably longer than the USFN timelines might suggest.

Nevertheless, unlike the SAI timelines, the USFN timelines reflect only the direct effects of state laws. After considering substituting the USFN timelines for the SAI timelines used in the Notice, FHFA will continue to use the SAI timelines, for several reasons. First, the SAI timelines more closely resemble actual Enterprise foreclosure experience and will therefore lead to estimates of state carrying costs that are closer to the Enterprises' actual carrying costs. Second, because the variation among states is very similar for both the SAI and the USFN timelines, the resulting fee increases would not differ greatly, although there would be some differences in the states that would be charged additional fees.

Third, because FHFA is primarily concerned about the drastic increase in foreclosure timelines in certain states since the housing crash, FHFA examined changes in USFN timelines between 2007 and 2012. That research suggests that changes in state law have had varying effects on foreclosure timelines over that period. Since 2007, the USFN timelines have increased for several states that also have very long SAI timelines, suggesting that changes in state law have had a significant effect on the SAI timelines in those states. For example, New Jersey's USFN timeline increased by 305 days from 2007 to 2012, suggesting that its long current SAI timeline is primarily due to changes in law. In some other states with long current SAI timelines, the USFN timelines have increased little or not at all, which suggests that factors other than changes in state law have had significant effect in those states. For example, Florida's USFN timeline is unchanged since 2007. There must, therefore, be other causes for Florida's long current SAI timeline, such as foreclosure processing backlogs. Although some factors contributing to the length of the SAI timelines, such as processing backlogs, are not strictly the result of state law,

[5] United States Foreclosure Network, *Foreclosure Timelines Matrix: State by State*, 2007.

they are largely the result of state foreclosure practices, are influenced by state law, and impose real costs on the Enterprises.

Cost Savings Ignored

One of the most common arguments in the public input was that state laws and practices that extend foreclosure timelines result in major cost savings to the Enterprises and benefit the economy as a whole. FHFA's methodology penalizes states for the costs caused by those laws, but offers no credit for the cost savings from the same laws. For example, efforts to encourage mortgage modifications for distressed borrowers cure some defaults and prevent other defaults from occurring altogether. If those modifications are sustainable and result in the borrower continuing to make his or her monthly payment over the long run, both the Enterprises and society avoid the costs associated with foreclosure.

Further, some writers argued that FHFA's use of a national expected default rate for all states does not reflect reality, since state default rates and default cure rates vary by state. Because FHFA's methodology does not use individual state expected default rates, there is no opportunity for the benefits and cost savings associated with state policies to be taken into account. Additionally, some writers asserted that states with stronger borrower protection laws tend to have lower default rates and higher cure rates as a result of those laws. Some input cited specific dollar estimates of cost savings to investors from specific state laws and required foreclosure mediation programs.

FHFA considered this issue carefully and identified several flaws in the above arguments. First, because the public input cited only anecdotal evidence, FHFA has little basis to conclude that any cost savings associated with these laws are substantial. Recent research has indicated that state laws such as the ones cited in the public input do not increase cure rates. One paper found that borrowers in judicial states are not more likely to cure or renegotiate their loans. On the contrary, the delays common in judicial states lead to a build-up of persistently delinquent borrowers, the vast majority of whom eventually lose their homes. Additionally, the "right-to-cure" law adopted in Massachusetts in 2008 lengthens foreclosure timelines but does not lead to better outcomes for borrowers than occur in neighboring states that did not adopt similar laws.[6] Further, another recent study determined that the key to minimizing the costs of foreclosures to communities would be to minimize the time that properties spend in the foreclosure process.[7]

Second, FHFA's methodology used an expected national default and foreclosure rate for an important reason: to avoid reflecting state housing market effects. State expected default rates would inevitably reflect the expected strength of the local housing market as well as state foreclosure laws and practices. Had FHFA used individual state expected default rates, states historically at greater risk of declines in house prices on the west and east coasts likely would rise to the top of the list in terms of estimated foreclosure costs. FHFA's intent was and is to focus on the factors that states can influence. Separating the effect of the local housing market from the effect of state laws on an individual state's expected default rate would be extraordinarily difficult.

Further, attempting to take into account the benefits of state law would require each Enterprise to develop, test, and implement loss severity models for each of the 54 states and other jurisdictions below the state level that it measures. After discussion with the Enterprises, FHFA concluded that developing such models would be a multi-year undertaking costing millions of dollars.

Although FHFA recognizes the theoretical merit of including the savings associated with state laws as well as their costs in its methodology, savings due to state laws are not easily quantifiable and do not appear to be substantial given current information. Taking those savings into account would also impose significant additional costs and operational difficulties on the Enterprises. Therefore, FHFA has decided to not change its methodology in this regard or its use of a national expected default rate.

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[6] Gerardi, K., L. Lambie-Hanson, and P. S. Willen, "Do Borrower Rights Improve Borrower Outcomes? Evidence from the Foreclosure Process," *Journal of Urban Economics*, (2013) 73(1): 1-17.

[7] Gerardi, K., E. Rosenblatt, P.S. Willen, and V. Yao, "Foreclosure Externalities: Some New Evidence." NBER Working Paper, No. 18353 (2012).

Servicer Behavior

A frequent argument made in the public input was that servicers, not borrowers, are responsible for most foreclosure delays and should, therefore, bear their cost. Several writers stated that servicers and their attorneys often do not provide required documents in a timely manner or do not show up for meetings and hearings. Others noted that FHFA's approach contains no data or analysis to support the contention that state laws, rather than servicer conduct, are responsible for foreclosure delays. Several letters attributed some or all of the delays shown in FHFA's Notice to robosigning and other documentation irregularities or to foreclosure moratoria in response to servicer misconduct. Some claimed that servicers intentionally fail to complete the foreclosure process in cases where the property has little value, thereby lengthening average timelines. Other letters stated that a reduction in Enterprise costs must begin with proper Enterprise and FHFA oversight of mortgage servicers, and that FHFA should impose compensatory fees on servicers that fail to comply with state laws. Additionally, writers claimed that federal preemption prevents states from properly regulating the conduct of servicers that are contractual counterparties of the Enterprises.

In response to that input, FHFA investigated Enterprise data regarding the causes of foreclosure delays. Although the Enterprises collect information on the timing of legal actions in each foreclosure process, the data do not indicate the causes of delays. Lacking more concrete evidence, it is impossible to attribute foreclosure delays to servicers alone or even in the majority of cases. Anecdotal evidence suggests that servicer or foreclosure attorney behavior, borrower behavior, foreclosure backlogs, and other factors are all common reasons for extended foreclosure timelines. Contrary to what some writers claimed, FHFA's SAI timelines do not include the effects of foreclosure moratoria imposed by states, servicers, or the Enterprises. Most importantly, however, although FHFA acknowledges that there have been widespread cases of servicer misconduct, FHFA found no evidence that servicer behavior is worse in the states with long foreclosure timelines than in states with shorter timelines to a degree that would explain differences in the length of those timelines in whole or in large part. Finally, while FHFA and the Enterprises have been working diligently to improve servicer performance and accountability, servicer oversight and the determination of compensatory fees imposed on servicers are beyond the scope of this initiative.

Violation of Federalism

Several letters FHFA received argued that the approach was an improper violation of Federalism. The public input indicated that it is inappropriate for FHFA, as a federal executive agency, to attempt to influence state legislative actions or interfere with state judicial procedures. Writers argued that regulation of mortgage foreclosures has always been exclusively a state function, with no federal role, or that state laws regarding foreclosure represent the will of the people of the respective states, and that it is undemocratic for FHFA to oppose those laws. Some also claimed that FHFA's approach exceeded its authority as conservator.

FHFA believes that those writers misunderstand the purpose of the approach outlined in the Notice. FHFA's approach aims to recover the above-average costs in the highest-cost states for the benefit of taxpayers and borrowers in lower-cost states, rather than attempt to change state law. FHFA's statutory mandate to conserve the assets of the Enterprises and protect taxpayers gives the agency ample legal authority to require the Enterprises to charge different guarantee fees on mortgages originated in different states. The argument that this approach is an unprecedented federal intrusion on a purely state-regulated process is not historically correct. The federal government has long had a role in foreclosure issues through the chartering of government-sponsored enterprises and the activities of Federal agencies such as the Federal Housing Administration (FHA).

Nothing in the approach outlined in FHFA's Notice prevents state legislatures from taking actions that extend foreclosure timelines. States are still free to implement any borrower protection laws they see fit. Similarly, FHFA, which Congress has assigned the task of conserving Enterprise assets, is free to direct the Enterprises to recover the costs of these laws.

No Foreclosure Standard

Several letters observed that FHFA's approach takes no stand on the adequacy of individual state foreclosure processes and would do nothing to encourage consistency or improvement in those practices. They argue that the approach is neutral about how long foreclosure should take in any state, and that, if the national average foreclosure timeline increased, the agency would be indifferent. Those writers claim that FHFA could do more to reduce Enterprise costs by helping to create a national foreclosure standard.

That view appears to be a misreading of the intent of the Notice. As conservator, FHFA is concerned about the cost to the Enterprises from the extraordinary lengthening of foreclosure timelines in recent years. The approach outlined in the Notice focused on five states where the average total carrying cost is much higher than the national average because foreclosure timelines and costs in those five states are extraordinary relative to other states. The aim of the approach is to recover some of those extraordinary costs. A national foreclosure standard is outside the scope of the initiative and would likely create a host of other objections and claims of federal intrusion.

State-Level Fees are Anti-Borrower

A frequent theme in the public input was that the approach is fundamentally an anti-borrower measure. Many argued that state laws that extend foreclosure timelines were put in place for the protection of borrowers and that documented widespread servicer misconduct justifies strong borrower-protection laws. Others claimed that the proposed fees would particularly harm borrowers with low incomes and in depressed housing markets, which are more prevalent in the five states than nationally. Some writers stated that there is no relationship between the problem and the remedy: new borrowers would be unfairly charged to compensate for misconduct of servicers of old loans.

FHFA rejects those arguments, as the approach seeks to compensate the Enterprises for excessive costs expected to be incurred in very high-cost states. The intent is simply to treat borrowers in those states fairly relative to borrowers on other states. Because the costs imposed by existing borrowers are not the focus of the approach, there is no mismatch of problem and remedy. Further, the proposed fees are based on expected national default costs on new loans, not the performance of loans made to past borrowers. Therefore, the cost should be borne by new borrowers. FHFA recognizes that laws and practices that extend timelines in some states may provide benefits to borrowers in those states and makes no judgment about the appropriateness of those laws and practices. If in fact the benefits exceed the costs, borrowers in the states should be willing to pay the costs themselves, rather than expect them to be paid primarily by federal taxpayers or borrowers in other states. Finally, FHFA has taken many actions to protect borrowers and their interests during the conservatorship of Fannie Mae and Freddie Mac, including multiple lawsuits filed against major banks and servicers. Since the inception of the conservatorships, FHFA also has aggressively pushed foreclosure alternatives through the Home Affordable Refinance Program (HARP), the Home Affordable Modification Program (HAMP), and other loan modification programs, encouraged deeds-in-lieu of foreclosure and short sales, and approved extensive mortgage forbearance. As of August 2013, the Enterprises under FHFA's direction had completed more than 2.97 million foreclosure prevention actions.[8]

4.) Plan for Implementation of State-Level Upfront Fees

After evaluating the public input, FHFA has decided to proceed with implementing upfront guarantee fee increases on single-family loans in extraordinarily high-cost states using a revised version of the methodology outlined in the September 2012 Notice.

<u>Updated Data</u>

At FHFA's direction, both Enterprises have revised the individual carrying cost models to incorporate the most current available data at the time of the revision. The five categories of data

[8] Federal Housing Finance Agency, Foreclosure Prevention Report, August 2013, p. 4, online at: www.fhfa.gov/AboutUs/Reports/Pages/FHFA-August-2013-Foreclosure-Prevention-Report-.aspx.

that were revised are: 1) SAI foreclosure timelines, 2) unable-to-market (UTM) periods, 3) costs per day, 4) the national default and foreclosure rate, and 5) state weighting factors.

The SAI timelines are published approximately every six months, with each new set of timelines reflecting changes to average state foreclosure timelines that have been observed recently or that the Enterprises expect to occur shortly. FHFA replaced the June 2012 SAI timelines cited in the September 2012 Notice with the SAI timelines that were released in February 2013. The February 2013 release left most states' timelines unchanged. The largest change was Pennsylvania's 120-day increase, which reflected recent Enterprise foreclosure experience that indicated that the state's previous SAI timeline was unrealistically short. Had the one standard deviation fee threshold described in the September 2012 Notice been continued, loans made in Pennsylvania would have incurred a fee of 10 basis points. Under the new fee structure, Pennsylvania will not be charged a fee.

The second part of the total foreclosure timeline calculation, the UTM period, was updated as well. The UTM periods in the September 2012 Notice reflected Enterprise experience from January 1, 2012 to June 30, 2012. The updated UTM periods reflect experience from July 1, 2012 to December 31, 2012 and are shown in Table 2 below. Only Maryland has changed, with a decrease from 120 days to 90 days.

In addition, FHFA has added a new component to the timeline calculation that was not included in the September 2012 Notice, covering the time needed to evict former homeowners or tenants post foreclosure. An investor may have obtained a legally marketable title to a property, reaching the endpoint of the timeline described in the Notice, but still be unable to dispose of the property because the former owner or tenants will not vacate or execute a new lease voluntarily or have filed suit. In those cases, which are much more common in certain states than others, additional time is needed to complete an eviction as required by state law. Because prospective buyers are typically unwilling to purchase occupied REO properties, the dwellings cannot be effectively marketed for sale until all occupants have vacated.

In most states, the post-foreclosure eviction process tends to be short because the borrower has already had an opportunity to challenge the foreclosure before the foreclosure sale. In some states, however, state law gives borrowers and other occupants opportunities post-foreclosure to challenge the foreclosure and prolong the eviction period. The eviction process can add significantly to the time required for the Enterprises to dispose of REO properties post-foreclosure.

In recognition of that issue and at FHFA's request, the Enterprises jointly developed post-foreclosure "eviction timelines" for each state based on 1) how frequently an REO property is occupied, 2) how frequently an eviction action or the completion of litigation is required, and 3) the average time necessary to complete an eviction and litigation. Those timelines approximate the average additional time that eviction-related delays impose on each new defaulted loan that goes through foreclosure in a particular state. Because the timelines are averages for all newly-acquired loans, they can be added to the SAI timelines and UTM periods to produce total foreclosure timelines for each state.

For example, if 50 percent of REOs in a hypothetical state are occupied at foreclosure, 50 percent of those occupied REOs require an eviction, and the typical eviction takes 100 days, the product of 50 percent x 50 percent x 100 days = 25 percent x 100 days = 25 days. The result of that calculation is then rounded to the nearest 30 days. Therefore, for this state, an additional 30-day eviction timeline would be added to the SAI timeline and the UTM period, if applicable, to reach the total foreclosure timeline. Making this change to account for eviction timelines, as shown in Table 2 below, affected only 12 states. In all of the other states, the calculation either rounded to 0 days or the sample size was too small to evaluate. As can be seen in Table 2, delays related to post-foreclosure evictions are most significant in Massachusetts.

The Enterprises also updated the state-level cost per day data. In the September 2012 Notice, the cost per day data reflected Enterprise experience for the entire year 2011. The updated data primarily reflects experience from January 1, 2012 to July 31, 2012, with the exception of the cost of funds, which is a snapshot of the bond market taken on February 14, 2013. Taxes, insurance, and legal expenses reflect experience form August 1, 2011 to July 31, 2012. As with the other categories of revised data, this was the most current data available at the time the model was updated.

Another element of each Enterprise's carrying cost model is the expected national default and foreclosure rate on newly acquired loans. To determine that rate, each Enterprise has used a proprietary model that reflects decades of experience and incorporates economic variables as well as the characteristics of loans and borrowers that affect the probability of default. In the estimates used for the September 2012 Notice, the mix of business assumed by the models reflected loans delivered to the Enterprises from January 1, 2012 to June 30, 2012. Both Enterprises have updated their estimates assuming the mix of business delivered from July 1, 2012 through December 31, 2012.

Finally, the carrying cost calculations use state-level weights in several places. Those reflect each state's percentage share of the total unpaid principal balance of loans acquired by both Enterprises combined. Because each Enterprise's state-level acquisition volume is proprietary information, FHFA calculates the combined weights and provides them to the Enterprises. For the September 2012 Notice, the weights reflected loans acquired from January 1, 2012 to June 30, 2012. In this document, the weights have been updated to reflect loans acquired from July 1, 2012 to December 31, 2012.

Revised Schedule of Fees

Using this updated data, the Enterprises applied appropriate rates of discount to produce present-value estimates of expected total default-related carrying costs for a new mortgage in each state. Those state-level estimates were produced separately by Fannie Mae and Freddie Mac. FHFA weighted each Enterprise's estimates by its respective approximate market share in recent years to produce a single set of estimates. FHFA then calculated the standard deviation from the mean of the state-level estimates of expected total default-related carrying costs.

Table 2
Estimated Time to Obtain Marketable Title to a Vacant Property and Cost Per Day, with Standard Deviations from the National Mean

State[1]	2013 SAI Foreclosure Timeline in Days[2]	Estimated Average "Unable-to-Market" Time in Days	Eviction Timeline in Days	Total Time to Obtain Marketable Title to Vacant Property in Days	Basis Points Per Day	Total Basis Points (Total Time * Cost Per Day)	Standard Deviations from National Mean[3]	Rank[4]
AK	300	0	0	300	1.62	485	-1.02	8
AL	240	0	0	240	1.62	388	-1.35	1
AR	280	0	0	280	1.75	489	-1.01	10
AZ	300	0	0	300	1.59	477	-1.05	6
CA	330	0	30	360	1.60	577	-0.71	17
CO	360	0	0	360	1.51	544	-0.82	15
CT	690	0	30	720	1.97	1417	2.12	52
DC	300	0	0	300	1.51	454	-1.12	3
DE	480	0	0	480	1.48	708	-0.27	25
FL	660	0	0	660	2.14	1410	2.10	51
GA	270	0	0	270	1.81	488	-1.01	9
GU	500	0	0	500	1.80	899	0.37	36
HI	530	90	0	620	1.31	814	0.09	32
IA	450	0	0	450	2.01	907	0.40	37
ID	440	0	0	440	1.60	706	-0.28	24
IL	480	60	30	570	2.25	1280	1.66	50
IN	480	0	0	480	1.90	911	0.41	38
KS	330	90	0	420	2.01	842	0.18	34
KY	420	30	0	450	1.73	779	-0.03	29
LA	390	0	0	390	1.90	743	-0.15	27
MA	440	0	90	530	1.73	918	0.44	40
MD	485	90	30	605	1.71	1032	0.82	46
ME	570	0	0	570	1.68	956	0.57	42
MI	270	180	0	450	2.10	943	0.52	41
MN	270	180	0	450	1.72	772	-0.05	28
MO	240	0	0	240	1.93	462	-1.10	4
MS	270	0	0	270	1.94	524	-0.89	13
MT	360	0	0	360	1.58	568	-0.74	16
NC	330	0	0	330	1.60	528	-0.88	14
ND	405	60	0	465	2.06	957	0.57	43
NE	330	0	0	330	2.07	685	-0.35	23
NH	270	0	30	300	1.96	589	-0.67	20
NJ	750	0	0	750	2.00	1499	2.40	53
NM	450	60	0	510	1.62	829	0.14	33
NV	360	0	0	360	1.61	580	-0.70	18
NY	820	0	30	850	2.00	1696	3.06	54
OH	450	30	0	480	2.11	1012	0.76	45
OK	420	0	0	420	1.92	806	0.06	30
OR	390	0	0	390	1.60	623	-0.56	21
PA	600	0	30	630	1.94	1222	1.46	49
PR	720	0	0	720	1.12	809	0.07	31
RI	420	0	30	450	1.90	855	0.23	35
SC	420	0	0	420	1.73	725	-0.21	26
SD	360	180	30	570	1.85	1056	0.90	47
TN	270	0	0	270	1.73	467	-1.08	5
TX	270	0	0	270	2.37	639	-0.50	22
UT	330	0	0	330	1.46	482	-1.03	7
VA	270	0	0	270	1.52	412	-1.27	2
VI	510	0	0	510	1.80	917	0.44	39
VT	510	30	30	570	1.87	1067	0.94	48
WA	330	0	0	330	1.58	521	-0.90	12
WI	450	30	0	480	2.10	1010	0.75	44
WV	290	0	30	320	1.54	491	-1.00	11
WY	270	120	0	390	1.49	581	-0.70	19
National Weighted Average	405	16	16	438	1.71			

[1] Includes the District of Columbia and certain U.S. territories.

[2] Foreclosure time frames are available online at: https://www.efanniemae.com/sf/guides/ssg/relatedservicinginfo/pdf/foreclosuretimeframes.pdf and http://www.freddiemac.com/learn/pdfs/service/exhibit83.pdf.

[3] Standard deviations shown in this column are calculated on the "Total Basis Points (Total Time * Cost Per Day)" column immediately to the left. The mean for this dataset is 787.9, with a standard deviation of 296.8.

[4] Rank is based on the standard deviations shown in the column immediately to the left. States with higher standard deviations from the mean have a higher rank.

Under FHFA's revised methodology, states greater than two positive standard deviations from the national mean, Florida, Connecticut, New Jersey and New York are considered statistical outliers and will be charged an additional upfront fee of 25 basis points. The standard deviations from the mean of the four states' total carrying costs are shown in Table 3 below. These are best estimates, but remaining imprecision has led FHFA to not distinguish among the four high-cost states. Collectively, the 25 basis point fee approximates the projected marginal carrying cost to the Enterprises in those states in excess of the national average carrying cost, assuming that the volume and mix of business in the future is similar to those in recent months and that default rates in each state are at projected national averages.

Table 3
State Level Fees

State	Standard Deviations from Mean[1]	New State-Level Upfront Fee (in basis points)	Est. Impact on Monthly Pmt. on $200,000 Mortgage[2]
Florida	**2.10**	**25**	**$5.95**
Connecticut	**2.12**	**25**	**$5.95**
New Jersey	**2.40**	**25**	**$5.95**
New York	**3.06**	**25**	**$5.95**

[1] Standard deviations are calculated on the values in the "Total Basis Points (Total Time * Cost Per Day)" column in Table 2.
[2] Assumes that the upfront fee increase or decrease is five times greater than its effect on the yield of the mortgage. The calculation assumes a $200,000, 30-year, fixed-rate mortgage with a 4.5 percent coupon rate with monthly principal and interest payment with no additional fee of $1,013.
Source: FHFA

The column in Table 3 entitled "Est. Impact on Monthly Pmt. on $200,000 Mortgage" shows the estimated monthly payment equivalent of the upfront fee on an average-sized mortgage, assuming that the upfront fee increase is five times greater than its effect on the yield of the mortgage, which is typical. The estimates also assume a $200,000, 30-year, fixed-rate mortgage with a 4.5 percent coupon rate and a monthly principal and interest payment of $1,013. The estimated increase in monthly costs resulting from the higher upfront fees would be $5.95 per month, which is a sufficiently small amount that FHFA does not expect will significantly affect either borrower or lender behavior. However, given the volumes of loans that Fannie Mae and

Freddie Mac acquire annually in the affected states, these small fees will compensate the Enterprises for substantial expected losses.

Implementation

Because the Enterprises have traditionally priced upfront guarantee fees on a uniform basis nationally, the changes announced herein will require some adjustment to lender and servicer systems and practices. In anticipation of that, FHFA released the Federal Register Notice in September 2012 to prepare the market for the change and to solicit input that could ease any transition. FHFA has directed the Enterprises to implement the fee changes indicated in Table 3 for all approved lenders in the form of an adverse market fee in the four states with an effective date of April 1, 2014. The Enterprises will charge lenders those fees for all loans acquired on or after the effective date.

The Enterprises will provide their lenders with additional detail and guidance on implementation issues. FHFA intends to annually update its state-level upfront guarantee fees using the latest data. FHFA also expects to enhance its measurement of carrying costs and foreclosure timelines in future revisions as well. Therefore, the states charged fees in future revisions may differ from those listed here.

FHFA has carefully considered the views in opposition to this action. Nevertheless, the dramatic increases in timelines seen in certain states have created fundamentally unfair cross subsidies between borrowers in different states because the current pricing regime fails to account for the material difference in the risk of loss across states. Additionally, to the extent those cross subsidies are not addressed, increased foreclosure timelines impose costs on taxpayers, whom FHFA is charged with protecting. FHFA believes that, in this approach, it has found a reasonable way to recover a portion of the above-average foreclosure-related costs in those states where costs are the highest, while imposing a minimum of hardship on borrowers and avoiding disruptions to housing markets and the nation's housing finance system.