FHFA Reports to Congress on G-Fees

By: Jann Swanson | Thu, Dec 19 2019, 12:46 PM

The two government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac charge guarantee fees or g-fees to lenders when they acquire their single-family loans. These are expected to cover several costs that the GSEs incur in providing their guarantees.

In addition to the expected costs when borrowers fail to make their payments, there are administrative costs and a 10-basis point obligation to the U.S. Treasury as required by the Temporary Payroll Tax Cut Continuation Act of 2011.

The fourth component, **the cost of holding capital to protect against the potential of catastrophic losses from loan defaults is by far the most significant**. In 2017 the GSEs began using the Federal Housing Finance Agency's (FHFA's) Conservatorship Capital Framework (CCF) which is the amount of capital required multiplied by a GSE's target rate of return, to calculate the cost of holding capital.

Using the CCF and its own proprietary data each GSE determines the estimated cost of guaranteeing a loan. Any gap between the fee charged on a loan and its estimated cost is the measure of estimated profitability of acquiring a loan. At acquisition, each GSE expects to earn a positive return, whether above or below its target amount.

A final factor in determining g-fees is competition between the two GSEs and with other lenders such as the FHA or private label lenders. **The GSEs may adjust their fees to retain market share.**

The Housing and Economic Recovery Act of 2008 requires the GSEs' regulator and conservator FHFA to conduct an ongoing study of the guarantee fees and submit an annual report to Congress. FHFA released that report on Thursday. It compares year-over-year 2018 to 2017 and provides data over five years back to 2014.

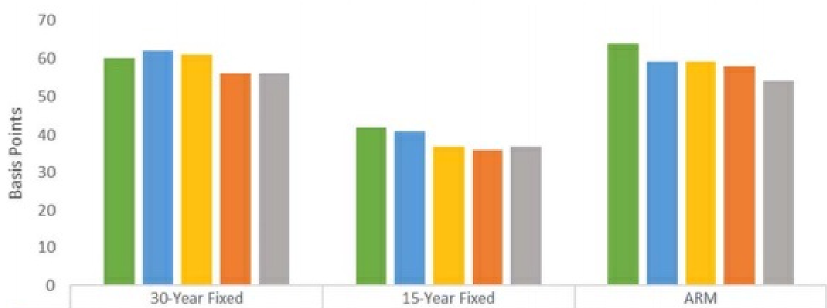
There are two types of g-fees. The first type, **upfront fees** (which Fannie Mae calls loan level price adjustments and Freddie Mac refers to as delivery fees) are one-time payments made by lenders when they deliver fees to the GSEs. **The second, ongoing fees**, are collected each month over the life of the loan. Both types are, of course, ultimately passed through by lenders to their borrowers.

Ongoing fees are based primarily on the product type, such as a 30-year fixed rate. Upfront fees are used to price for specific risk attributes, such as the LTV ratio and credit score.

FHFA says that the average single-family **guarantee fee for all loan products increased from 2017 to 2018 by 2 basis points (bps) to 55 bps**. The increase was accounted for solely by the on-going portion (based on product type and loan term) which rose to 40 bps while the upfront portion based on loan characteristics such as credit scores, was unchanged at 15 bps.

Within the ongoing fee charges, the average guarantee fee on 30-year fixed-rate loans was unchanged at 56 basis points, while the fee on 15-year fixed-rate loans increased by 1 basis point to 37 basis points. The fee on adjustable-rate mortgage (ARM) loans fell 4 basis points to 54 basis points.

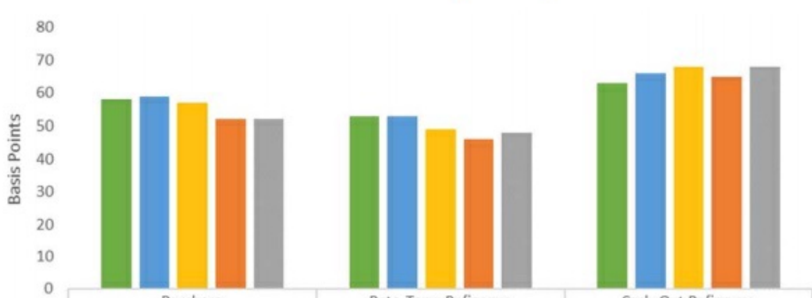
Chart 3: Guarantee Fee by Product Type



	30-Year Fixed	15-Year Fixed	ARM
2014	60	42	64
2015	62	41	59
2016	61	37	59
2017	56	36	58
2018	56	37	54

Higher interest rates accompanied by increasing house prices in 2018 led to a smaller share of both rate-term refinances and 15-year loans acquired by the Enterprises. The larger share of purchase loans and a growing focus on pilot programs for first-time homebuyers and affordable housing led to a slight increase in the share of loans with higher loan-to-value (LTV) ratios and lower credit scores.

Chart 5: Guarantee Fee by Loan Purpose



	Purchase	Rate-Term Refinance	Cash-Out Refinance
2014	58	53	63
2015	59	53	66
2016	57	49	68
2017	52	46	65
2018	52	48	68

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