GSE Activity Report

Thursday, June 30, 2022

Equitable Servicing Standard Time?

Summary

The Federal Reserve Bank of Philadelphia's latest report on foreclosure risk includes a worrisome finding: the sharp rise in interest rates means that most loan-mod recipients won't actually get much relief. This combined with troubling data on GSE loan-mod results and racial equity could spur FHFA intervention if market conditions worsen.

Analysis

This report focuses on FHA and GSE Loss Mitigation Program performance, finding that rising interest rates jeopardize their long-term payment reduction goals. In addition to updating forbearance and performance numbers through June 7, the report is methodologically different from the previous month's in that it uses current market rates instead of the lower of the contract rate or current market rate to compute Recovery Mod targets. The effects are performance outcomes that are much worse, and, despite a continued downward trend in foreclosure starts, the authors predict increasing prospects for foreclosure and greater difficulty in the home sales that might otherwise prevent them without successful implementation of home-retention options. Another area of concern includes a redefault rate of 10 percent on loans servicers identify as having exited loss mitigation, despite strong housing market conditions.

So far, these haven't proven all that good. For the GSE Flex Mod program, the report finds that at the 5.25 percent modification rate starting on June 14, only 22 percent of modifications meet the program's stated twenty percent principal and interest reduction target. It attributes this to the program's 80 percent mark-to-market loan-to-value constraint on deferrals of principal balances and rising housing prices, suggesting that dropping this constraint would allow almost all mortgages to meet their targeted payment reductions. It does not explain how the GSEs could do so if MIs are unwilling to back these HLTV modifications.

The report's findings on FHA loan performance goals are similarly troubling, with only ten percent of 30-Year Term mortgages meeting the FHA COVID-19 Recovery Mod program's 25 percent P&I reduction target. Twelve percent of the 40-Year Term mortgages meet the program's reduction target.

Outlook

The report also recalculates persistent racial group inequities in past-due mortgage rates, with 6.8% of Black and 4.3% of Hispanic borrowers in this state compared to 2.8% for white and 1.8% for Asian borrowers. In their equitable-finance plans, Fannie and Freddie were principally focused on increasing loan availability and opening new special-purpose credit programs. Should market conditions worsen, continuing data along those in this Fed report may lead to demands for equitable-servicing standards atop all these others.

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