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FHFA watchdog sounds alarm on $4.6B loss

GSE fails to recover losses from strategic defaulters

By: Christina Mlynski -September 25, 2013

Mortgage giant **Freddie Mac** failed to refer nearly 58,000 foreclosed homeowners who owed $4.6 billion on their guaranteed loans, thereby neglecting its chance to seize properties from those who defaulted on mortgage payments, a government report alleges.

Furthermore, Freddie Mac eliminated any possibility of recovering deficiencies when the enterprise failed to refer a large number of foreclosed mortgages to the appropriate department for collections, the **Office of Inspector General for the Federal Housing Finance Agency** said.

Interestingly enough, most of these foreclosed mortgages were associated with properties in states where Freddie did not pursue deficiencies, but where **Fannie Mae** did — with some success.

"It's a fairly small number in the scheme of things," explained **Cato Institute** director of financial regulation studies Mark Calabria.

He added, "But I think it reinforces the current nature of mortgage finance policy, which is not to hold borrowers responsible. This isn't just about Freddie, but it's also about these borrowers sticking it to the taxpayer."

Real estate investors and other borrowers that stopped repaying their loans while keeping current on their bills were among those not pursued, according to the report.

The issue at hand is the message being sent, OIG explained. The risk is that by not targeting those who stop paying, there is no effective warning sent to others who may choose a similar path, the OIG explained.

Going forward, strategic defaulters should be pursued even if recoveries are only a fraction of what is owed, the oversight report concludes.

"FHFA can increase its assurance that Freddie Mac is consistently and prudently pursuing deficiencies by requiring the enterprise to pursue deficiencies from borrowers with the ability to repay, where allowed by state law and regardless of the foreclosure sale type (i.e. real estate power and third-party sales)," the OIG expressed.

The **Federal Housing Finance Agency**, conservator of both government-sponsored enterprises, stated in the report that its deputy director Jon Greenlee has taken the necessary steps to tighten controls over deficiency collections.

The OIG also said Freddie Mac may be exposing itself to reputational risks by allowing borrowers with the ability to repay to avoid repayment of deficiencies, which only encourages strategic defaulters.

Freddie Mac contractually requires vendors to complete their evaluation of referred foreclosure sales within five to 15 days of receiving data from the enterprise.

However, this contract requirement was rarely enforced due to extended delays in obtaining the necessary documents from servicers and foreclosure attorneys, according to the report.

"Although Freddie Mac is aware of the delays, the enterprise has not specified a timeframe for counterparties to provide foreclosure-related documents to its vendors," the OIG explained.

The report continued, "Nor has Freddie Mac implemented monitoring controls to prioritize deficiency collection activities in states with brief statutes of limitations. Similarly, FHFA has not directed Freddie Mac to establish such controls."

Going forward, the OIG says the FHFA should review all of Freddie Mac’s systems for overseeing servicers, foreclosure attorneys and collection vendors involved in the deficient recovery process. The inspector's report also advises the GSE to develop consequences for those parties who fail to meet delivery deadlines.