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Mortgage fees could go up in some states

Fannie, Freddie agency to release study 'soon' on loan fee structure

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WASHINGTON (MarketWatch) — Borrowers in some states including New York may face additional mortgage fees depending on what a federal housing regulator will say in a report expected to be released as soon as this week.

The Federal Housing Finance Agency plans to release a paper that examines whether it will change the way it collects fees for guaranteeing credit risk into one that depends on state-specific mortgage default risks, a situation that could also impact investor appetite in the mortgage market.

Fannie Mae (OBB:FNMA) and Freddie Mac (OBB:FMCC) buy whole mortgages from banks and other direct lenders and package them into bonds and mortgage-backed securities. They charge investors a "guarantee fee" in return for backing the bonds they sell. The agency last month hiked the across-the-board fee they charge on single-family mortgages by an average of 10 basis points.

The fee changes are intended to limit credit risk after costing taxpayers $188 billion.

FHFA acting director Edward DeMarco said last week that the agency will release a study and seek input from observers about whether it makes sense to impose an upfront fee on mortgages Fannie and Freddie buy in states where the two firms are "likely to incur default-related costs that are significantly higher" than the national average.

The shift would be a major change from the way the guarantee fee currently works, which seeks to smooth out regional differences in mortgage guarantee pricing.

Thomas Cronin, managing director at the Collingwood Group in Washington, said that in states such as New York, a so-called judicial state because it allows court processes for borrowers in foreclosures, it may take three years for a foreclosure to be completed. Meanwhile, states such as California, a non-judicial state that does not permit court-supervised reviews of foreclosures, a foreclosure can clear in months.

Cronin notes that because Fannie Mae and Freddie Mac must take much longer to recover their investment in a judicial state, the cost of foreclosure is much higher there, and therefore the fee the firms charge for guaranteeing a mortgage in such states should be higher.

For example, Fannie and Freddie could charge an estimated 10 basis points in guarantee fees equal to $200 more a year to guarantee a $200,000 mortgage in a judicial state – a cost that will be passed on to borrowers, Cronin said.

However, Susan Wachter, professor of real estate and finance at the University of Pennsylvania, said that state-by-state variations in guarantee risk pricing would be driven much more by large differences in each state's housing market and economy than by foreclosure rules. She said that a regional risk-based system will hike mortgage interest rates even more in some states and could create a much more volatile system nationally.

"When risk increases you will have a sharp price increase in some markets but because you have mortgage securitization, risk is everywhere," Wachter said.

A related skirmish over whether cities have the right to seize and restructure troubled mortgages — a concept known as eminent domain — could be factored into guarantee fees as well, said Mark Calabria, director of financial regulation studies at the Cato Institute. If some cities decide they can seize mortgages in this fashion, guarantee fees in those states should go up because it adds to Fannie and Freddie's risks, Calabria said.

Calabria added that regional variances in guarantee fees, could help the overall mortgage-backed securities market. "If political and legal risk started to be better priced, then I believe investors would be more comfortable with it," he said.

Cronin said there is reason to support efforts to adjust the guarantee fee based on significant differences among states, adding that it could impact how people think about the foreclosure policies in their states.

“It’s the expense,” Cronin said. “Hopefully the people in judicial foreclosure states, suffering from backlogs, will rise up and say ‘I’m not going to pay for my next-door neighbor who hasn’t made a payment in a number of years