HOW GSE NOTE SALES UNDERMINE HOMEOWNERSHIP

A CALL FOR REFORM

National Consumer Law Center
Fighting Together for Economic Justice

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EXECUTIVE SUMMARY

Congress has charged the housing giants Fannie Mae and Freddie Mac (the government-sponsored enterprises or GSEs) with the goals of supporting and expanding homeownership. Yet, during the COVID-19 pandemic, the Federal Housing Finance Agency (FHFA), Fannie and Freddie have undercut—and continue to undercut—these goals through bulk sales of hundreds of thousands of home loans to investors, thereby ending these borrowers' access to the streamlined loss mitigation programs the agencies created to help financially struggling homeowners save their homes.

Instead of accessing GSE loss mitigation offerings and their clear eligibility rules, borrowers whose loans are sold are left with weak and opaque options developed by the investors who take over these loans. For example, many borrowers harmed by the pandemic who were told they could apply for GSE loss mitigation programs to put their missed payments at the end of the loan were blindsided by a new servicer who explained that those options were no longer available because the new owner of the loan did not offer them. GSE guidelines that describe the loss mitigation options that the buyer of the loan must offer are so vague and weak that they do not ensure meaningful home retention options will be available.

Compounding this issue is the lack of accurate, comprehensive data about the outcome of sold loans. In fact, there is no data publicly available for the more than 545,000 reperforming loans sold. We do not know anything about their performance or what loss mitigation options have been offered or provided post-sale for those that re-defaulted. And, while the FHFA has published data on nonperforming loan sales, it is based on an outdated control group and does not reflect accurate conclusions based on today's market. The FHFA and GSEs do not have sufficient data to fully understand what happens to the loans once the loans are sold.

It is concerning that these sales have continued during the pandemic, cutting borrowers off from sustainable GSE COVID options when they need them the most. Borrowers of color have been disproportionately harmed by the pandemic and have needed more time in the forbearance program. They have remained in default on their mortgages longer. The sale of these borrowers' loans, and the resulting significant loss of home-retention options, undermine the goals of the recently established GSE Equitable Housing Finance Plans to create and preserve home ownership for borrowers of color. Continuing to conduct note sales deviates from this mission and ignores the potentially devastating effect of these sales on borrowers, particularly those hit hardest by the COVID pandemic.

While the GSEs must attend to their balance sheets, this must be done in a manner consistent with their broader public mission.

Recommendations

To minimize the loss of vital loss mitigation options for homeowners with GSE loans and promote home retention, FHFA must implement further guardrails on the note sale program, including:

Pre-sale protections

- Exclude from sales loans that are in a forbearance plan, including a COVID-related forbearance plan;
- Prohibit the sale of any loan that is in default until the servicer completes an evaluation for all GSE loss mitigation options, including COVID-19 options, offers eligible borrowers a loss mitigation plan, and documents the evaluation;
- Mandate that *before* a loan is designated for sale, the GSE must notify the borrowers that this action is anticipated and that the loan will not be sold unless the current servicer has considered the delinquent borrower for all applicable GSE loss mitigation options and offered the borrower a plan if eligible;

Post-sale protections

- Require purchasers to offer the GSE payment deferral program to eligible borrowers;
- Require purchasers to use the lower of the current market interest rate or the existing loan interest rate when offering the borrower a loan modification;
- Require purchasers to offer loss mitigation options that aim to provide a set reduction, such as 20%, in the borrower's monthly payments;

Transparency and accountability

- Provide updated data analysis for nonperforming loans with relevant benchmark periods on loan performance post-sale;
- Report performance data for reperforming loans; and
- Ensure that data reporting includes demographic data, including race and ethnicity.

This report reviews the loss mitigation programs offered by the GSEs. It then describes what happens to homeowners when those options are unfairly eliminated through the loan sales. Finally, the report spells out reforms that the GSEs should adopt.

INTRODUCTION

The two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, play a critically important role in the residential mortgage market. These GSEs own or guarantee over half of the nation's home mortgages. Their policies set national standards for the mortgage servicing industry.

Fortunately, the GSEs were quick to develop effective responses to the COVID-19 pandemic. Learning from their past experiences with the Great Recession foreclosure crisis, Fannie Mae and Freddie Mac created flexible foreclosure avoidance options for homeowners who were facing defaults due to the pandemic. They developed new servicing guidelines that allowed homeowners to access forbearance plans and pause their monthly payments for a period of time, without complicated preconditions. After a forbearance or delinquency, the GSEs required their servicers either to defer missed payments to the end of the loan term or to modify the loan in order to reduce payments.

Unfortunately, at the same time the GSEs were offering help to borrowers recovering from the pandemic, they continued to sell off hundreds of thousands of the home loans that they owned or guaranteed—in particular, loans that were currently in default and loans that had been in default but were now performing, typically due to a loan modification. The sales handed the loans over to private investors, which then have broad discretion to foreclose without offering the modification or deferral options that the GSEs developed for their own loans. These note sales effectively cut off the homeowners most in need from the GSE's effective loss mitigation programs.

Through these sales, hundreds of thousands of homeowners have lost the protections afforded by the GSE servicing guidelines without notice and often without any opportunity to qualify for a GSE solution to their default. The guidelines for note purchasers provided by the Federal Housing Finance Agency (FHFA), acting as conservator for the GSEs, are too vague and insufficient to provide any meaningful protection for borrowers, putting borrowers at risk of losing the homes they worked so hard to buy and retain.

Compounding the issue, the GSEs and FHFA have failed to make accurate data public that would fully document the note sale program's effect on borrowers. Without sufficient data on the performance of sold loans, the FHFA cannot effectively monitor or predict the fate of homeowners whose loans have been sold out from under them. Instead, the GSEs are actively pursuing loan sale programs during the ongoing pandemic that systemically eliminate effective reinstatement options for thousands of homeowners who now have no alternative but foreclosure. We know that Black and Hispanic borrowers have been hit the hardest by the pandemic and have spent more time in forbearance plans, and in

A Millville, New Jersey, borrower had a Fannie Mae loan that was sold in 2018. Due to a COVID hardship, she entered into a three-month forbearance plan and as the plan ended, the loan servicer denied her additional forbearance. She applied for a loan modification and was orally told that she was approved but was not told when the first payment was due. She did not receive anything in writing. She did not know the payment date until she tried to make a payment in December, and was told it was too late and that the loan had been sent to foreclosure. The loan modification and all other home retention options were denied and a foreclosure is now pending.

default, than white borrowers. There is concern that they are being placed at greater risk of foreclosure by the sale of their defaulted loans.

In this report, we review the loss mitigation programs offered by the GSEs and what happens to homeowners when those options are unfairly eliminated through the sale of the loan, especially during the pandemic. We provide stories from homeowners whose loans were sold to illustrate the real-life consequences of this practice. We discuss how the GSEs and FHFA have inadequately estimated these harms because of their failure to collect and analyze accurate and sufficient data. Of particular concern is the effect of these policies on borrowers of color who were disproportionately affected by the pandemic. Finally, we provide recommendations to the GSEs and FHFA on crucial policy changes needed to minimize the risks to homeowners and more constructively contribute to the GSEs' homeownership mission.

I. UNDERSTANDING THE GSE LOAN SALE PROCESS

Two categories of mortgage loans are involved in the GSE loan sales. The largest in volume have been "reperforming" loans. These are loans that have been or are currently delinquent but have reperformed for a period of time. Many were modified, most often through the now expired federal Home Affordable Modification Program (HAMP). The other group consists of "nonperforming" loans that typically had been in default for several years before they were sold. The two GSEs, Fannie Mae and Freddie Mac, sell nonperforming loans through auctions that are organized in a similar way. Fannie Mae also uses this auction structure when it sells reperforming loans. Freddie Mac, however, uses a securitization system to transfer interests in reperforming loans. The mechanics of these systems are discussed in more detail below.

The important fact for homeowners is that for all of these programs, buyers are under no obligation to service the loans in accordance with GSE servicing guidelines. This means, for example, that buyers are bound to offer only up to

Glossary

CARES Act: The Coronavirus Aid, Relief, and Economic Security (CARES) Act was a $2.2 trillion package of emergency assistance approved in 2020 in response to COVID-19. It provided up to 12 months of forbearance relief for borrowers with Federally Backed Loans which includes GSE loans.

Forbearance: a temporary suspension of payments, including principal and interest and any escrowed payments required to be paid in the mortgage contract.

GSE loan: loans owned or guaranteed by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac").

HAMP: The Home Affordable Modification Program (HAMP) was a loan modification program introduced by the federal government in 2009 to help struggling homeowners avoid foreclosure. The program's focus was to help homeowners who paid more than 31% of their gross income toward mortgage payments. The program expired at the end of 2016.

Loss mitigation: the process in which a mortgage lender or servicer offers relief or repayment options to a borrower struggling to keep up with loan payments.

Loss Mitigation Waterfall: Loss mitigation options are generally structured as a series of steps to give borrowers the help they need at the lowest cost. If the first, lowest-cost alternative is insufficient, the borrower will move to the next option.

Loan modification: a change made to the terms of an existing loan because the borrower is unable to meet the payments under the original terms.

12 months of forbearance as required by the 2020 CARES Act, not up to 18 months as the GSEs require, and after the forbearance period ends they need not offer any of the GSEs' loss mitigation or loan modification options. Borrowers who entered into a GSE forbearance program with the expectation that they could access up to 18 months of forbearance and comprehensive post-forbearance options and then had their loans sold are, without notice or warning, stripped of all of these protections.

a. The mechanics of GSE nonperforming loan sales

The GSEs began to sell nonperforming loans in 2014. From 2014 through June 2022 Fannie Mae and Freddie Mac auctioned off 155,034 nonperforming loans.[1] The auctions have taken place several times per year. Each auction consists of between two and five loan pools, with each pool containing from several hundred to several thousand mortgage loans. While a few pools were regionally concentrated, most pools included a nationwide selection of loans. However, loans from the judicial foreclosure states of New Jersey, New York, Florida, Pennsylvania, and Illinois made up over half of the nonperforming loans sold.[2]

The GSEs' sales of nonperforming loans peaked in 2016, with the sale of most of the severely delinquent GSE loans that remained from the Great Recession.[3] Large institutional investors purchased an overwhelming majority of the nonperforming loans. Five investors purchased more than half of the 155,034 loans sold.[4]

b. The mechanics of GSE reperforming loan sales

The GSEs define "reperforming" loans as loans that have been in default but became current for a period of time through a loan modification or other option. At the time of sale, they could be undergoing a short-term delinquency (less than three months) or be current. Many were modified under the HAMP program that was in effect from 2009 through 2016.

i. Fannie Mae reperforming loan sales.

In sheer numbers, Fannie Mae's sales of reperforming loans have far outnumbered the volume of its nonperforming loans sales. Fannie Mae began to sell off reperforming loans in 2016. As with nonperforming loans, Fannie Mae schedules four to five auctions of reperforming loans each year and offers several pools of loans in each sale. From 2016 through 2022 Fannie Mae auctioned off more than 375,000 reperforming loans.[5] In 2021, during the height of the COVID pandemic, Fannie Mae sold off 99,100 reperforming loans, the highest total for any year.[6] In recent years, several servicers, primarily Mr. Cooper, JP Morgan Chase, Bayview, and Shellpoint, referred the bulk of the reperforming loans for Fannie Mae to be sold. Mr. Cooper was the source of 88,260 of the reperforming loans that Fannie Mae sold during 2020–21.[7]

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ii. Freddie Mac's securitization of reperforming loans.

Freddie Mac has taken a different approach to unloading its servicing obligations related to reperforming loans. Rather than sell off whole loans in pools, Freddie Mac takes reperforming loans it owns or has previously securitized and re-securitizes them into new trusts.[8] Freddie Mac then sells off "participation interests" in the new trusts. Buyers acquire certificates giving them rights to get principal and interest payments from these trusts. Freddie Mac created two types of securitization vehicles to issue these certificates, either a "Seasoned Credit

Risk Transfer Trust" ("SCRT") or a "Seasoned Loan Structured Transaction" ("SLST").[9] Freddie Mac selects servicers for these entities.

Importantly, once reperforming loans are transferred into a SCRT or SLST trust, they "are serviced under a Pooling and Servicing Agreement and no longer serviced to the Freddie Mac Guide."[10] The newly designated servicers are told to continue to make CARES Act forbearance available, but the servicers have no obligation to follow the GSE guidelines for post-forbearance options, including deferrals, loan modifications, and other Freddie Mac loss mitigation options.[11]

Freddie Mac has been re-securitizing reperforming loans since 2016, typically in offerings made two-to-four times each year. During the three years 2019 through 2022, Freddie Mac securitized 112,192 reperforming loans through its SCRT trusts and 59.505 through SLST trusts.[12] The majority of these were loans that had been modified under the HAMP program.[13]

II. GSE BULK SALES DENY BORROWERS ACCESS TO STRONG FORECLOSURE ALTERNATIVES AND THREATEN HOME RETENTION FOR THE MOST VULNERABLE BORROWERS

a. The GSE's post-forbearance reinstatement options provide clear and targeted relief

When the COVID pandemic began, the GSEs implemented forbearances and foreclosure moratorium programs that effectively blocked a wave of foreclosures during 2020 to 2022. The GSEs also implemented new programs to help borrowers with the transition from forbearance to reinstatement and the resumption of payments.[14] If a borrower can afford to resume pre-pandemic payments, the GSEs offer a "deferral" of missed payments. In a deferral, the arrearage is converted to a non-interest-bearing lien due at the end of the loan term or when the property is sold.

If a borrower cannot afford the pre-pandemic payment, the GSE guidelines require that the servicer review the borrower for a specific type of loan modification. The GSE's "Flex Modification" capitalizes arrearages and targets a 20% reduction in the borrower's future principal and interest payment. Importantly, the GSE's Flex Modification for borrowers facing COVID-19 hardships allows borrowers to take the lower of their current loan interest rate or the modification rate set by the GSEs based on market data. With the current increase in interest rates, it is a significant benefit to allow some borrowers to keep their contractual interest rate.

The GSE guidelines mandate that their servicers review all borrowers emerging from forbearance for these deferral and modification options before they can foreclose. When borrowers do not respond to servicers' solicitations for review, servicers must make unsolicited offers of these options to borrowers who meet the basic eligibility requirements. These loan modifications can be very effective in reducing future payments, particularly because the GSEs allow borrowers impacted by the COVID pandemic to avoid interest rate increases when their loans are modified.

b. The GSE's failure to require review for GSE loss mitigation both before and after loans are sold deprives borrowers of vital GSE home retention options

> A Rhode Island borrower was in a Fannie Mae COVID forbearance agreement when the loan was sold. After the forbearance ended, the servicer sent a proposed modification that increased the payment by about $200 per month. The interest rate did not decrease from its current 6% even though the market rate at the time was lower. No amounts were deferred and the servicer would not review for a Flex-type modification. The borrower had to accept the unaffordable modification to save the family home and has struggled to make the payments.

Loans that are nonperforming are obvious candidates for loss mitigation options. Yet the GSEs have not implemented effective oversight to ensure that servicers review nonperforming loans for the GSE loss mitigation waterfall *before* they are sold. This means that otherwise qualified borrowers miss out on the comprehensive, sustainable GSE loss mitigation options aimed at home retention, increasing the risk of avoidable foreclosure, and undermining the GSE goal of promoting sustainable homeownership.

For both nonperforming and reperforming loans, if the borrowers remain in default or redefault after the sale, options to save the home are severely limited. Once a loan is sold to a private investor, the new owner has no obligation to comply with GSE guidelines that require servicers to conduct reviews for specific loss mitigation options before they can proceed with a foreclosure. For borrowers who have a change in circumstance that causes them to fall behind on their mortgage and need a more affordable payment, it is unfair to move from a system that accommodates such changes in circumstances with comprehensive options such as the Flex Modification to an unpredictable system that is based on vague guidelines and servicer discretion.

As discussed below, the GSE guidance on loan sales requires that buyers need only evaluate borrowers for a modification that "provides a benefit to the borrower and has the potential to be sustained by the borrower for the life of the modification."[15] This guidance is so vague that it does not ensure that sustainable loss mitigation is available. The sale of a GSE borrower's loan strips that borrower of all GSE foreclosure protections and loss mitigation options. A borrower who is not lucky enough to be reviewed for a GSE waterfall option sometime before their loan is sold, or encounters a change of circumstance after the loan is sold, is at the mercy of the new servicer to provide discretionary relief.

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Post-sale requirements for GSE note sales have evolved during the history of the program, beginning with guidelines that required buyers of certain NPLs to review borrowers for the comprehensive HAMP. With time, fewer loans qualified for this program. While additional rules for buyers were added, they were vague and ineffective, resulting in an ongoing lack of significant foreclosure prevention measures both before and after sale.

The GSEs initiated their programs to sell nonperforming loans as the nation emerged from the foreclosure crisis of the Great Recession. The GSE's initial loan sale guidelines from 2015 expressly directed buyers of nonperforming loans to evaluate borrowers for HAMP.[16] This requirement focused all loan buyers on a defined modification option. Borrowers did not lose access to the major crisis-driven modification option available at the time solely because their loan was sold. However, HAMP did not apply to mortgage loans originated after 2009. For the relatively few nonperforming loans originated after 2009 and subject to nonperforming loan sales, the 2015 GSE guidelines required only that the buyer evaluate the loan for a proprietary modification that did not include an upfront fee and that "must provide a benefit to the borrower with the potential for a sustainable modification."[17]

In April 2016, the GSEs added several new obligations for buyers of nonperforming loans.[18] If the loan had a loan-to-value ratio above 115%, the buyer had to review the loan for a principal reduction modification. Modifications had to include a fixed interest rate, with limited step increases allowed after five years consistent with HAMP. Otherwise, the guidelines did not suggest any objective standards for payment reduction or affordability, leaving these critical factors completely to the buyer's discretion. The 2016 revisions also prohibited nonperforming loan buyers from unilaterally releasing liens and "walking away" from vacant properties, leaving them to fall into disrepair and create a burden on the locality.

In revised guidelines published in early 2018, the GSEs left in place a requirement that buyers evaluate borrowers for a modification that "provides a benefit to the borrower and has the potential to be sustained by the borrower for the life of the modification."[19] The 2018 guidelines continued the requirement for a discretionary review for principal reduction modifications for significantly underwater properties and required that modifications set a fixed interest rate for five years. The guidelines also established a four-year reporting requirement for loan buyers, with these requirements binding on subsequent servicers.[20]

In its latest revised guidelines from May 2021, applicable to sales of both nonperforming and reperforming loans, the GSEs keep in place the vague outline of a modification standard announced in 2018. This is the requirement to evaluate for a modification that "provides a benefit to the borrower and has the potential to be sustained by the borrower for the life of the modification."[21] The 2021 guidelines only nod to the existence of the COVID pandemic by informing loan buyers that they must service loans consistent with the CARES Act's forbearance requirements, which require only a maximum term of 12 months of forbearance, not 18 months that the GSE forbearance option provides.[22] In other words, the 2021 GSE guidelines for loan buyers require only the limited forbearance already mandated by Congress and do nothing to align with the longer GSE forbearance timeline. They guidelines also do not address the borrower's need to reinstate a loan after forbearance beyond the pre-existing general requirement. As a result, borrowers who were approved for an authorized GSE forbearance program that relieves them from an ongoing payment obligation for up to 18 months are left in a precarious position, as the sale cuts them off from the GSE options designed to take the loan out of default and get it back on the reinstatement track.

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The GSE's guidance to buyers for post-forbearance relief is so vague that it threatens to be meaningless. As evidenced by the examples from the field in section III below, homeowners are losing out on longer GSE forbearance options and servicers are offering unaffordable modifications to borrowers whose GSE loans have been sold, setting them up for inevitable re-default and increased risk of losing their homes. Virtually any modification or deferment option that temporarily delays a foreclosure provides a "benefit to the borrower." Similarly, the requirement to review for a modification that has the "potential" to be sustained for the life of the modification is hollow. There is always a potential that an unaffordable modification can be sustained, for example if the borrower obtains higher-paying or additional employment or benefits from a financial windfall. The examples provided in this report do not demonstrate a strong likelihood of sustainable payments over the life of the loan and nevertheless were provided under post-sale contracts.

III. EXAMPLES FROM THE FIELD: GSE NOTE SALES HAVE HARMED HOMEOWNERS

The sale of GSE loans over the past several years has caused harm to borrowers who were shut out of GSE loss mitigation options when their loans were sold. Following are several examples of the struggles faced by homeowners after Fannie Mae or Freddie Mac sold their loans.

a. Failure to Provide Forbearance Relief

- A borrower from Antioch, Illinois, had a Freddie Mac loan that was sold in 2019. He faced a COVID hardship, but the loan was sold and Select Portfolio Servicing (SPS) the new buyer's servicer, orally offered him only two months of forbearance. Soon thereafter, the servicer reneged on even that minimal offer, and said it would forbear only the June 2020 payment for one month. The borrower would have to pay June and July's payments on July 1, 2020. He could not make these payments and asked several times for more forbearance but was denied because he had reportedly received the "maximum number of modifications" under the loan buyer's program. SPS has initiated a foreclosure.
- A borrower from Little Ferry, New Jersey, with a Freddie Mac loan sold in 2019 contracted COVID in mid-March 2020 and was not able to work. He had been current on his mortgage until then. He entered into a three-month COVID-related forbearance plan for April, May, and June with Select Portfolio Servicing (SPS), the servicer for the buyer of his loan. He was told that at the end, SPS would contact him with options to resolve the outstanding amounts. At the end of the forbearance period, SPS denied further forbearance. SPS did provide a trial payment plan (TPP) which the borrower completed. At the end, however, SPS refused to provide a permanent modification because of insufficient flood insurance, even though SPS would not provide any details as to the amount the insurance should be. The borrower obtained additional flood insurance but SPS refused to honor the TPP or provide a new modification offer. The borrower worked with an attorney and only with the help of the attorney was able to obtain an affordable modification.

b. Failure to Provide Sustainable Post-Forbearance Relief

- A Millville, N.J., borrower had a Fannie Mae loan that was sold in 2018. Due to a COVID hardship, she entered into a three-month forbearance plan with Fay Servicing, the buyer's servicer. After the plan ended, Fay would not offer her any further forbearance. She applied for a loan modification and submitted all the required documents in the summer and fall of 2021. In November 2021, she was orally told by a Fay representative that she was approved for a modification although she was not told when the first payment was due. She did not receive anything in writing. She did not know the payment date until she tried to make a payment in December and was told it was too late and that the loan had been sent to foreclosure. The loan modification was ultimately denied, and Fay filed a foreclosure action which is currently pending. Fay will not consider a deferral option or any other home retention options that are routinely available to homeowners with Fannie Mae loans.
- A Rhode Island borrower was in a Fannie Mae COVID forbearance agreement when the loan was sold on December 9, 2021 and Selene Finance began to service the loan for the buyer. After the forbearance ended, Selene sent a proposed modification with a trial payment plan. This proposed modification included a payment for principal, interest, and escrow of about $200 more per month than the borrower's pre-modification payment, a payment that was unaffordable and unsustainable for the borrower. It appears that the interest rate was 6% and no amounts were deferred. Although the borrower asked Selene to review her for a GSE Flex modification, Selene would only offer her this unaffordable modification
- A Houston, Texas, borrower had a Freddie Mac loan that was sold in 2019. In 2020 she began a nine-month COVID-related forbearance plan. At the end, the only option SPS, the servicer for the buyer of her loan, would provide was to repay all the forborne installments over 12 months, on top of her regular monthly payment. Even though this meant that the payments would be 66% of her monthly income, SPS said this was the only option they could offer her. It refused to allow her to defer the forborne payments to the end of the loan term "based on the delinquency of the account" even though she may have been eligible for the GSE COVID deferral if the loan had not been sold. She reluctantly accepted the plan but is already in default again.
- A borrower from Washington State had a Freddie Mac loan that was sold during the pandemic. After her forbearance plan, Fay Servicing, working for the buyer of the loan, only offered her an unaffordable modification

that increased the interest rate, shortened the repayment term by 10 years, and deferred some payments to the end of the loan. Because of the increased interest rate and shortened repayment term, the borrower's monthly payment increased by $396 per month. She could not afford the modification. Because Fay had initiated a foreclosure, the borrower felt she had no other option but to accept it. She requested to be reviewed for a GSE Flex-type modification, but Fay refused.

- Another borrower from Washington State was offered an 18-month forbearance payment plan from April 1, 2020 until September, 2021. He began requesting post-forbearance options, either a modification or deferral, before the end of the forbearance plan. Mr. Cooper, the servicer for the loan buyer, denied him both options. It said he was not eligible for a deferral because the loan was no longer owned by Freddie Mac. Around December 2021, he was told that if he paid down his loan so that it was only 18 months delinquent, Mr. Cooper could defer the past due amounts. The borrower made a payment of $5723 but was still denied a deferral plan. The Washington Department of Financial Institutions finally was able to obtain and review the recordings of the calls where Mr. Cooper promised the deferral in exchange for the lump sum payment. Mr. Cooper then granted the borrower a deferral in February 2022.

c. *Failure to Provide Sustainable Relief after Loan Sale*

- A Somerset, N.J., senior widow fell behind on her mortgage when her husband passed away in 2019. She connected with her loan servicer, Selene Finance, for a loan modification. She wanted a Flex Modification but was told the loan had been sold and was no longer with Freddie Mac. Selene said they did not know when the loan had been sold. She provided a modification application, including her fixed income of social security, and Selene offered her a modification that increased the interest rate from 6.75% to 7%, doubled her payment from $1,200 to $2,400 per month, and kept the same remaining term of 78 months. They simply capitalized all of the past due amounts and re-amortized over the remaining months at a higher interest rate. She will now have to work with an attorney to try and get a sustainable option.

IV. THE FHFA CANNOT ADEQUATELY PREDICT WHAT WILL HAPPEN AFTER NOTE SALES BECAUSE THE DATA IS SEVERELY DEFICIENT

FHFA has failed to consider or adequately analyze what happens to borrowers when these loans are sold, particularly now when many borrowers are facing significant financial challenges due to the pandemic and high interest rates. There is either a void of any data or data is based on an inappropriate benchmark group, as described below. As a result, the overly broad loss mitigation guidance that FHFA has provided to loan buyers does little to assist borrowers whose nonperforming loans are sold and immediately need loss mitigation or borrowers of sold reperforming loans who in the future may need comprehensive options offered by the GSEs to save their home.

a. FHFA has not provided data on post-sale performance of loans sold in reperforming loan sales

Fannie Mae and Freddie Mac, through FHFA, have regularly published data on the performance of loans sold through their nonperforming loan sale programs, most recently in FHFA's *Enterprise Nonperforming Loan Sale Report* (June 2022).[23] This Report provided data on the status of 128,087 nonperforming Fannie Mae and Freddie Mac loans sold during the years 2015–2021.

However, the GSEs have not informed the public of what data, if any, they collect to document what is happening with the far greater number of *reperforming* loans they have sold. In particular, we have no data on the extent to which the reperforming loans went into default and foreclosure after loan sales. When reperforming loans default, borrowers whose loans have been stripped of GSE protections face the same risks as borrowers whose loans were nonperforming when sold. As noted above, Fannie Mae has sold more than 340,000 reperforming loans since 2016, and in just the past three years Fannie Mae securitized more than150,000 reperforming loans. According to FHFA's May 2021 Reperforming Loan Sale guidance, buyers of reperforming loans must report on loan status for four years, but not if the borrower pays on the loan for 12 months.[24] It is not at all clear what level of detail, if any, is expected for ongoing RPL reporting or how this compares to the reporting FHFA requires after NPL sales. To evaluate the RPL sale program, FHFA needs to gather sufficient data to track what happens to all reperforming loans after they are sold, even those that remain current for 12 months. Data is necessary to determine how such loans fare in comparison to similarly situated loans that are not sold.

b. FHFA's reports on performance of loans sold in past nonperforming loan sales have no relevance to assessing the impact of loan sales in today's housing market

In FHFA's June 2022 report on the status of loans sold under the GSE's nonperforming loan sale program, Fannie Mae asserted that the outcomes for borrowers are more favorable for nonperforming GSE loans sold under the program when compared to nonperforming GSE loans not sold under the program.[25] According to Fannie Mae, of 152,251 NPL loans sold through 2021 and with reported outcomes, 36% avoided foreclosure during a four-year reporting period, while only 27% of loans in a benchmark group of loans that were not sold avoided foreclosure.[26]

A closer look at Fannie Mae's data does not reveal outcomes for the loan sale program that are as favorable as the GSE suggests. As reported by Fannie Mae, the portion of loans actually going to foreclosure was higher for the loans in the NPL program group than for a benchmark group of loans never sold (50% foreclosure rate for the NPL group and 48% for the benchmark group).[27] In addition, Fannie Mae's data accounts for only 87% of the benchmark loans[28] and offers no information about what happened with the remaining 13%. The "foreclosure avoided" category in itself is confusing because it includes outcomes that do not involve home retention at all, including loans sold through short sales and extinguished through a deed in lieu of foreclosure.[29] Another large portion of the total loans sold (18.5%) is listed simply as "unresolved," meaning that these loans still remain delinquent and were never modified after being sold.[30]

More importantly, the benchmark period chosen by Fannie Mae does not support comparisons that are relevant to today's mortgage market. Fannie Mae chose to compare the performance of the nonperforming loans it sold in 2015 through 2021 to the performance of a "benchmark" group defined as "enterprise loans that were one year or more delinquent as of December 31, 2013."[31] By definition, to be included in the benchmark group the loan had to have gone into default before the end of 2012.[32] This means that the benchmark loans defaulted during a period when property values were in one of the deepest declines ever seen. Unprecedented multi-year arrearages had routinely accumulated on these loans. By contrast, the NPL sale groups, particularly those Fannie Mae sold during 2017 to 2018, involved pools with increasingly smaller proportions of loans that were two or more years in default.[33] Fannie Mae's data shows that loans with shorter periods of default favor modifications.[34] Thus, the benchmark loans, which all defaulted before 2013, were not a valid basis for comparison with the loans sold in the 2015–2022 NPL sales, and certainly not comparable to loans in default and sold during the Covid-19 pandemic.

Mortgage defaults dating from the depths of the Great Recession are not comparable to those occurring during the COVID pandemic. Two events coincided to propel the foreclosure crisis that began in 2007–2008. One was the profusion of predatory loans originated in the years leading up to the crisis. Often these were loans originated with insufficient underwriting, disproportionately affecting low-income communities of color. The other was a dramatic fall in home values. Poor underwriting meant that many borrowers could not afford the loans, even with modifications. The declining property values led many borrowers to walk away from their homes. The defaults occurring as a consequence of the COVID-19 pandemic have been significantly different. Borrowers did not default because of toxic loan terms. During the pandemic, property values rose dramatically. With rising property values, foreclosure becomes a more attractive option for servicers and investors. The outcomes during a period of low-market pressure to foreclose are obviously an inappropriate benchmark for comparison to outcomes during a period of high-market pressure.

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In addition to the different causes for today's defaults and a markedly different housing market, loss mitigation options have changed substantially since 2012. To populate its benchmark group, Fannie Mae focused on loans that went into default prior to 2012. These loans were generally subject to HAMP and similar modification protocols that required documentation from borrowers. These paperwork requirements created friction between borrowers and the loan servicers at the time. On the other hand, the GSE modification protocols that replaced HAMP after 2016 have focused on streamlined calculations and implementation that requires little or no borrower input. This is particularly true for the options the GSEs created to assist borrowers struggling to get past the COVID-19 pandemic, most of which do not require any borrower documentation and are designed for GSE servicers to implement with minimal borrower contact. This means that borrowers who defaulted during the pandemic era but whose loans were not sold, retain access to the GSEs loss mitigation options and have a particularly good chance of saving their homes. Using outdated data as a comparison point—data from before the GSEs streamlined their loss mitigation options—will understate the impact of losing those options. Servicers' handling of long-term loan defaults that occurred during the Great Recession is not an accurate predictor of how today's servicers will implement the more efficient GSE's loss mitigation protocols in use today.

c. FHFA's nonperforming loan sale data did not evaluate the long-term sustainability of the foreclosure alternatives offered by loan buyers

According to FHFA's June 2022 Nonperforming Loan Sales Report, buyers modified 24,724 of the 152,251 loans sold since 2014.[35] Fannie Mae did not provide details about the affordability of these modifications. According to Fannie Mae, 67% of the modifications provided a payment decrease, while 33% either increased or did not change the borrower payment.[36] Of the 24,724 modifications approved since 2014, 16,323 (66%) remained active as of June 2022.[37] What happens to these loans during the time frame after five years from their sale dates is important, but FHFA does not report data covering this longer time period.

Buyers of distressed mortgage loans often have business models that involve holding on to loans for five-year terms, then re-selling them as performing loans. To accomplish this, the buyers modify loans to reduce payments for five years to create a record that the loan is performing. However, the modification might include significant step increases in the interest rate after the initial five years. In 2015, FHA specifically barred buyers under its loan sale program from engaging in this practice.[38] It appears that the GSEs never issued similar guidance prohibiting the practice by nonperforming and reperforming loan buyers. If the GSEs do not prohibit this practice and conduct oversight to prevent it, the modification data they provide (limited to a four-year period for nonperforming loan sales) has little value.

V. THE LACK OF OUTCOME DATA FOR SOLD LOANS TOGETHER WITH THE SHARP REDUCTION IN LOSS MITIGATION OPTIONS FOR SOLD LOANS RAISES PARTICULAR CONCERN FOR BORROWERS OF COLOR

The severe loss of GSE loan modification options when a loan is sold, along with the lack of accurate data on the impact of the sales presents a significant concern, particularly for borrowers harmed by the pandemic. The impetus for the loan sale programs was a requirement of the GSE's Senior Stock Purchase Agreement with the U.S. Treasury that obligated the GSEs to reduce their retained portfolios by $250 billion for each GSE.[39] The GSEs have articulated several different goals for the loan sale programs, including "to reduce the number of seriously delinquent loans that Fannie Mae owns, to help stabilize neighborhoods and to help meet the portfolio reduction targets required under the Senior Preferred Stock Purchase Agreement with the United States

Treasury."[40] Transferring troubled loans to private investors clearly achieves one of the program's announced objectives—the sales favor the GSE's bottom line by reducing their exposure to heightened guarantee claims and other losses related to lengthy foreclosures. The extent to which the sales benefit the GSEs' bottom line is quantifiable. However, the impact of the sales on the most vulnerable borrowers requires more effort to assess, particularly during the pandemic.

Despite this lack of outcome data and the limitations on loss mitigation options for note sales, the GSEs have continued the program, even during the pandemic, undermining efforts to give GSE borrowers robust, sustainable COVID-specific relief. Because borrowers of color were disproportionately harmed by the pandemic and have spent more time in forbearance and default than white borrowers, there is great concern that those with GSE loans will have their notes sold and will have fewer sustainable options to save their homes. During the pandemic, Black and Latino/Hispanic borrowers have been more likely than white borrowers to miss their monthly mortgage payments due to financial difficulties, and were less likely to refinance during the large decline in interest rates.[41] Black adults have been more likely than white adults to take on debt to pay for household necessities and to be uncertain about their ability to pay for housing.[42] While the 2020 CARES Act provided payment relief in the form of forbearance for all borrowers with federally backed loans, Black and Latino/Hispanic borrowers have been less able than white borrowers to resume their monthly mortgage payments[43] and continue to have the highest rate of delinquency.[44] For borrowers with GSE loans that are sold, there is no guarantee they will be given the full GSE 18-month forbearance period if needed and have the same comprehensive COVID-specific loss mitigation options available to them. The sale of a loan makes it even harder for GSE borrowers of color to keep the GSE loans, and homes, they worked so hard to obtain.

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While FHFA and the GSEs recently announced a commitment to address barriers faced by Black and Latino/Hispanic communities to initially access homeownership through the 2022–2024 Equitable Housing Finance Plans,[45] the note sale program counteracts this goal by limiting home-retention options. The Fannie Mae Plan states, "[t]he goal of this Plan is to advance greater equity in America's housing finance system, its practices, and its outcomes"[46] but the outcome of the note sales program is the opposite: borrowers who are down on their luck, fall behind, and have their loans sold are stripped of all of the GSE protections to save their home when they need them the most.

VI. RECOMMENDATIONS: FHFA AND THE GSES MUST CHANGE THEIR LOAN SALE PROGRAMS TO ENSURE THAT THE PROCESS PROMOTES SUSTAINABLE HOMEOWNERSHIP

The GSEs should implement further protections in the note sale programs to prevent borrowers from losing access to essential home retention alternatives.

a. Pre-sale protections

1. *No sales of loans that are in forbearance.* The GSEs should not sell any loans that are in a forbearance plan, including a COVID-19 forbearance. (These loans should be reviewed for post-forbearance GSE loss mitigation, as per below.)
2. *Pre-sale loss mitigation reviews.* All borrowers should be fully evaluated for GSE loss mitigation options, including the GSE Flex Modification and Deferral if applicable, and offered such options where found eligible before a GSE designates any loan for sale. Stripping away access to the GSE flexible reinstatement options for borrowers, particularly those who needed forbearance as a result of the pandemic, undermines efforts to broaden the reach of GSE lending. The GSEs should require that servicers document these evaluations before the loan can be referred to a sale.
3. *Homeowner notice.* Before a loan is designated for sale, the GSE should notify the borrower that this action is contemplated and that the loan will not be sold unless the current servicer has reviewed the borrower for all GSE loss mitigation options and found the borrower ineligible.

b. Post-sale protections

4. *Deferral offers.* For loans that are sold, the GSEs should require purchasers to offer a deferral program to borrowers who can afford their pre-hardship mortgage payment but cannot afford to catch up on the payments they missed. This is particularly helpful for those whose circumstances change after the sale. The GSE deferral program helps borrowers who no longer face a hardship and simply seek to resume their former payment by making the forborne amounts due at the end of the mortgage term. Borrowers should not lose this option upon a note sale. This requirement does not burden purchasers, as deferral-type programs are now standard in the servicing industry. In fact, it allows purchasers to start receiving revenue on the loans by providing a sustainable option for borrowers to resume making payments.

5. *Retention of current interest rates.* The GSEs should not allow note sale purchasers to increase interest rates as part of loan modifications. The GSEs allow borrowers to keep their existing note interest rate in a modified loan if the interest rate cannot be reduced due to current market conditions. This is particularly important now with the sharp rise in interest rates. If the GSEs prohibit interest rate increases after loan sales, purchasers still retain the benefit of the bargain by having loans at the interest rate they had when they purchased the loans, and borrowers will avoid an interest rate spike.
6. *Post-sale modifications.* The GSEs should require purchasers to evaluate borrowers for a loan modification with a targeted payment reduction that applies throughout the remaining life of the loan. The GSEs have implemented a loan modification waterfall that aims to create a 20% principal and interest reduction in the monthly payment or reach a 40% housing expense to income ratio. The GSEs should require loan purchasers to implement a similar targeted payment reduction in their loss mitigation options.

c. Transparency and accountability

7. *Public data reporting.* The GSEs should report performance data to FHFA for reperforming loans, including demographic data, including race and ethnicity, to enable the GSEs, FHFA and outside stakeholders to evaluate the costs and benefits of the program. The data reporting for RPLs should not be the same as the current reporting for NPLs. As explained above in section IV(c), the modification outcome data reported for NPLs does not assess affordability or long-term outcomes. The performance data reported for RPL and NPLs should be consistent for both and include an evaluation of the affordability of options and their long-term performance beyond a five-year period.
8. *Updated benchmarks.* The GSEs should provide updated data analysis for nonperforming and reperforming loans that use benchmark periods relevant to today's mortgage market. FHFA's past NPL loan performance reports are not relevant to assessing the outcome for loans sold in today's market. The benchmark loan group Fannie Mae focused on contained loans that defaulted before 2013. These were not a valid basis for comparison with the loans sold in the 2015–2022 NPL sales and certainly not comparable to loans in default and sold during the Covid-19 pandemic. There should be updated data based on current market conditions.

ENDNOTES

1. FHFA Enterprises Non-Performing Loan Sales Report June 2022 p. 4.
2. Id. p. 11.
3. Id. p. 5.
4. Id. p. 19, listing Goldman Sachs/ MTGLQ Investors LP, Lone Star, Pretium Mortg. Credit Partners I Loan Acquisition LP, and Rushmore Loan Management Services, LLC, and VRMTG ACQ, LLC.
5. Fannie Mae Capital Markets Whole Loan Sales.
6. Id.
7. Id.
8. Freddie Mac Capital Markets Seasoned Loan Offerings Reperforming Loan (RPL) Senior/ Subordinate Offerings.
9. Freddie Mac Seasoned Loan Offerings p. 6 (Sept. 2019).
10. Freddie Mac Capital Markets Seasoned Loan Offerings Reperforming Loan (RPL) Senior/ Subordinate Offerings.
11. Federal Housing Finance Agency, Fact Sheet Non-Performing and Reperforming Loan Sale Requirements.
12. Freddie Mac Capital Markets Seasoned Loan Offerings Reperforming Loan (RPL) Senior/ Subordinate Offerings.
13. Id.
14. Fannie Mae Lender Letter 2021-07 (updated 11/17/21) and 2021-02 (updated 6/30/21); Freddie Mac Bulletin 2021-35, 2021-24, and 2021-8.
15. February 12, 2018 Non-Performing Loan Sale Guidelines; May 27, 2021 Fact Sheet: Non-Performing and Reperforming Loan Sale Requirements.
16. March 2, 2015 FHFA Requirements for Non-Performing Loan Sales by Fannie Mae and Freddie Mac. http://capitalmarkets.freddiemac.com/seasonedloanofferings/docs/NPL_Seminar_FHFA_for_site.pdf
17. Id.
18. April 14, 2016 Enhancements to Non-Performing Loan Sales Program. https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-PRM-Program-and-Further-Enhancements-to-NPL-Sales-Reqts.aspx
19. February 12, 2018 Non-Performing Loan Sale Guidelines.
20. Id.
21. May 27, 2021 Fact Sheet: Non-Performing and Reperforming Loan Sale Requirements.
22. Id.
23. https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/June-2022-NPL-Sales-Report.pdf (released December 21, 2022).
24. Federal Housing Finance Agency, Fact Sheet: Non-Performing and Reperforming Loan Sale Requirements p. 3 (May 2021).
25. Federal Housing Finance Agency, Enterprise Non-Performing Loan Sales Report June 2022.
26. Id. p. 12.
27. Id.
28. Id.
29. Id. p. 21.
30. Id. pp. 21-22
31. Id. p. 12.

32. According to FHFA, as of December 31, 2015 there were 199,619 portfolio loans that were one or more years in arrears. Report p. 6. Of these loans, 47,601 (23.8%) were five or more years in arrears. Another 72,947 (36.5%) were two-to-five years in arrears.
33. Id. p. 6.
34. Id. pp. 16, 31.
35. Id. pp. 25-26.
36. Id. p. 27.
37. Id. p. 24.
38. U.S. Dept. of HUD, Fact Sheet Distressed Asset Stabilization Program Enhancements.
39. Federal Housing Finance Agency Office of Inspector General, NPL Sales: Additional Controls Would Increase Compliance With FHFA's Sales Requirements, pp. 8-10 Audit Report AUD 2017-006 (July 24, 2017) (discussing implementation of GSEs non-performing loan sale program following FHFA's 2014-15 strategic planning directives for the GSEs). The strategic goals of FHFA's planning directives included: "Reduce Taxpayer Risk through Increasing the Role of Private Capital in the Mortgage Market." Id. at p. 8. Consistent with the goal of reducing the GSEs' portfolio of less liquid assets, FHFA directed the GSEs to develop plans for reducing their retained portfolios to favor assets with higher liquidity. Id. at p. 9.
40. Fannie Mae Capital Markets, Whole Loan Sales, Non-Performing Loan Sales.
41. Kristopher Gerardi, Lauren Lambie-Hanson, and Paul Willen, Racial Differences in Mortgage Refinancing, Distress, and Housing Wealth Accumulation during COVID-19, Federal Reserve, Bank of Boston (June 22,2 021).
42. Lindsay M. Monte and Daniel J. Perez-Lopez, COVID-19 Pandemic Hit Black Households Harder Than White Households, Even When Pre-Pandemic Socio-Economic Disparities Are Taken Into Account, US Census Bureau (July 21, 2021).
43. See Kristopher Gerardi, Lauren Lambie-Hanson, and Paul Willen, Racial Differences in Mortgage Refinancing, Distress, and Housing Wealth Accumulation during COVID-19, Federal Reserve, Bank of Boston (June 22, 2021); New Data on the Characteristics of Mortgage Borrowers During the COVID-19 Pandemic, CFPB Office of Research Special Issue Brief, Consumer Financial Protection Bureau p. 6 (March 2022).
44. Making Forbearances More Effective to Keep More Borrowers in Their Homes, The RADAR Group, Federal Reserve Bank of Philadelphia p. 5 (Third Quarter 2022); New Data on the Characteristics of Mortgage Borrowers During the COVID-19 Pandemic, CFPB Office of Research Special Issue Brief, Consumer Financial Protection Bureau p. 6 (March 2022).
45. FHFA News Release: FHFA Announces Equitable Housing Finance Plans for Fannie Mae and Freddie Mac (June 2022).
46. Fannie Mae Equitable Housing Finance Plan p. 2.

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