Federal Housing Finance Agency
Office of Inspector General

Home Affordable Refinance Program

A Mid-Program Assessment

Evaluation Report • EVL–2013–006 • August 1, 2013

Synopsis

August 1, 2013

Home Affordable Refinance Program

Why OIG Did This Report

The Federal Housing Finance Agency (FHFA), in coordination with the U.S. Department of the Treasury (Treasury), announced the Home Affordable Refinance Program (HARP or program) in March 2009. HARP is a streamlined refinance program for loans owned or guaranteed by Fannie Mae or Freddie Mac (collectively, the Enterprises) that is designed to assist borrowers who are current on their loans, but have not been able to refinance because they have little or no equity in their homes.

FHFA Office of Inspector General (OIG) conducted this program evaluation to assess FHFA's administration and oversight of HARP.

What OIG Found

When HARP was announced in March 2009, Treasury and FHFA estimated that four to five million borrowers would have the opportunity to refinance under the program. As of September 2011, however, fewer than one million of those borrowers had refinanced. Based on consultations with lenders and feedback from borrowers, FHFA directed the Enterprises to modify the program, which resulted in HARP 2.0. The program is currently scheduled to expire on December 31, 2015.

As a result of the initial HARP 2.0 program modifications and subsequent changes made throughout 2012 and 2013, HARP refinance volume has substantially increased. As of March 2013, 2.4 million HARP refinances had been completed. It is difficult, however, to project how many HARP-eligible loans will ultimately be refinanced. Several unknown variables, including interest rates, lender participation, and borrowers' willingness to refinance, make any estimate uncertain.

Today, impediments to the program's success remain. Educating borrowers and encouraging their participation continues to be a major challenge. FHFA is planning to address this by implementing a nationwide public education campaign.

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ABBREVIATIONS

Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
G-Fee	Guarantee Fee
HARP or program	Home Affordable Refinance Program
HERA	Housing and Economic Recovery Act of 2008
HHF	Hardest Hit Fund
LPMI	Lender Paid Mortgage Insurance
LTV	Loan-to-Value Ratio
MBS	Mortgage-Backed Securities
OIG	Federal Housing Finance Agency Office of Inspector General
Treasury	U.S. Department of the Treasury

PREFACE

OIG was established by the Housing and Economic Recovery Act of 2008 (HERA),[1] which amended the Inspector General Act of 1978.[2] OIG is authorized to conduct audits, investigations, and other studies of the programs and operations of FHFA; to recommend policies that promote economy and efficiency in the administration of such programs and operations; and to prevent and detect fraud and abuse in them.

This report provides an assessment of HARP, which is designed to assist borrowers who have little or no equity in their homes to refinance their home loans, as long as they are current on their mortgage payments. As of March 2013, more than 2.4 million homeowners have obtained a HARP refinance.

This report was prepared by Alexa Strear, Investigative Counsel, and Brian Harris, Investigative Counsel. OIG appreciates the assistance of FHFA, Fannie Mae, and Freddie Mac staff in completing this report. It has been distributed to Congress, the Office of Management and Budget, and others and will be posted on OIG's website, www.fhfaoig.gov.

George F. Grob
Deputy Inspector General for Evaluations

[1] Pub. L. No. 110-289.

[2] Pub. L. No. 95-452.

CONTEXT

The Benefits and Obstacles of Refinancing a Mortgage

Refinancing a mortgage is a common practice for American home owners. The process involves a borrower acquiring a new loan to pay off the original mortgage in full.[3] This releases the borrower from the terms of the original mortgage while binding the borrower to the terms of the new one. Most residential mortgage contracts in the United States contain no borrower prepayment penalty. Thus, at any time, a borrower has the option to prepay a mortgage in full without penalty. Because refinancing a mortgage involves obtaining an entirely new mortgage, however, the borrower is subject to many of the standard upfront costs associated with any new mortgage. These costs are associated with a new appraisal, origination fees, title search and insurance, attorney and settlement fees, and taxes.

There are several reasons a borrower may want to refinance a mortgage. A borrower may wish to obtain a lower interest rate,[4] reduce the aggregate monthly payment, obtain a different amortization period, or change the mortgage product (e.g., move from an adjustable rate mortgage to a fixed rate mortgage). A borrower's incentive to refinance increases as interest rates fall because the cost of borrowing money is reduced. Accordingly, the borrower's monthly housing payment can be decreased by refinancing to a mortgage with a lower interest rate. For example, the United States experienced refinancing waves in 1992-1993, 1998, and 2001-2003. During each of those three time periods, interest rates fell more than two percentage points.

> The **loan-to-value** ratio is calculated by dividing a mortgage's unpaid principal balance by the current market value of the property securing the mortgage.

There are certain environmental and borrower variables that can make it more difficult to refinance a mortgage, including (1) tightened lending standards, (2) poor borrower credit, and (3) changes in property values that reduce the borrower's equity. Each of these three obstacles has manifested itself as a result of the recent housing crisis, making it difficult for some borrowers to take advantage of record-low interest rates. For example, a traditional refinance of an Enterprise-owned mortgage requires a borrower to have a maximum **loan-to-value (LTV)** ratio of 80%, unless the loan contains a credit enhancement such as mortgage insurance. As home prices fell during the housing crisis,

[3] The term "borrower" in this report refers to a mortgagor – a person who has obtained a loan in exchange for a security interest in the property.

[4] By borrowing at a lower interest rate, a borrower will pay less interest over the term of a loan.

homeowners lost a portion of the equity they once had in their homes. For many borrowers, the lower home value left them with little remaining equity or, worse, underwater on their mortgages.[5] These highly leveraged borrowers are often unable to refinance their loans through conventional means, even if they have good credit and are paying their mortgages timely.

HARP

In March 2009, FHFA, in conjunction with Treasury, announced HARP. HARP is a streamlined refinance program for loans owned or guaranteed by the Enterprises that is designed to assist borrowers who (1) have little or no equity in their homes, and (2) are current on their monthly mortgage payments. To qualify for this streamlined refinance opportunity, a borrower must satisfy a variety of eligibility requirements, which have changed several times during the program's history. Figure 1 outlines today's eligibility criteria.

FIGURE 1. HARP-ELIGIBILITY CRITERIA AS OF JUNE 2013

Loan Requirements	Borrower Requirements	Result Requirements
• Current LTV must be greater than 80% • Loan must be owned or guaranteed by the Enterprises • Loan must have been delivered to the Enterprises on or before May 31, 2009 • Loan must be a first lien	• Borrower must be current on the mortgage payments at the time of the refinance • Borrower has had no late payments on the mortgage in the past 6 months • Borrower has had no more than one late payment on the mortgage in the past 12 months • Borrower has not previously refinanced under HARP	• HARP refinance must result in at least one of the following benefits to the borrower: ➢ A reduction in the borrower's monthly principal and interest payment ➢ A reduction in the borrower's interest rate ➢ A reduction in the amortization term ➢ A conversion to a more stable mortgage product

In addition to allowing HARP-eligible borrowers to take advantage of historically low interest rates, the program allows them to refinance into mortgages that may lower their monthly mortgage payments, move them to more stable mortgages, or shorten their mortgage terms to build equity faster. By helping this subset of borrowers refinance into mortgages with more favorable terms, FHFA hopes to reduce the risk of future defaults.

[5] A mortgage is considered underwater if the borrower owes the lender more than the market price of the home.

To establish HARP, FHFA directed the Enterprises to define specific eligibility requirements and to implement the program. However, as secondary market participants, the Enterprises do not directly lend to borrowers. Thus, a HARP-eligible borrower must refinance with a mortgage lender in the primary market to participate in the program. Because neither FHFA nor the Enterprises have the authority to require lenders to originate loans, lender participation in HARP is entirely voluntary. Nevertheless, by directing the Enterprises to implement HARP, FHFA is seeking to create a lending environment in which HARP-eligible borrowers are able to obtain financing from lenders.[6]

HARP 1.0

When HARP 1.0 was announced, Treasury and FHFA estimated that four to five million borrowers would have the opportunity to refinance under the program.[7] This estimate represented the number of borrowers who were eligible for a HARP 1.0 refinance at that time.

By September 2011, however, 987,910 borrowers had completed HARP 1.0 refinances. FHFA, the Enterprises, lenders, and other stakeholders identified several issues with HARP 1.0 that were causing this lackluster result. Among them were:

- Loans with LTVs greater than 125% were not eligible for HARP 1.0 refinances;
- The short program duration of approximately 15 months discouraged lenders from investing resources to market and originate HARP loans;
- The risk of **representation and warranty** liability deterred lender originations;
- Manual property appraisals were required for the majority of HARP 1.0 originations;
- Lenders were not permitted to solicit directly HARP-eligible borrowers for refinancing; and
- Risk-based fees increased up-front borrower costs and diminished the benefit of a lower interest rate.

Representations and warranties are assurances that lenders make to the Enterprises about the quality of loans being purchased or guaranteed by the Enterprises. If an Enterprise determines that a loan does not meet the criteria that the lender claimed the loan met, then the Enterprise may issue a request to the lender to repurchase the loan.

[6] Detailed reasons for lender participation are described below.

[7] The term "HARP 1.0" refers to the Home Affordable Refinance Program between April 2009 and October 2011. The term "HARP 2.0" refers to the Home Affordable Refinance Program from November 2011 to the present. The term "HARP" refers to the Home Affordable Refinance Program in its entirety.

Accordingly, FHFA directed the Enterprises to collaborate with stakeholders to address these concerns and improve the program. After several modifications were agreed upon, FHFA publicly announced them in October 2011, rebranding the program as HARP 2.0.

HARP 2.0

a. October 2011 Modifications

FHFA's initial HARP 2.0 modifications incorporated five important changes to the HARP-eligibility criteria. First, FHFA and the Enterprises removed the 125% LTV ceiling. This expanded the HARP-eligible population to include seriously underwater borrowers. Second, FHFA extended HARP's duration by 18 months. This extension was intended to increase lender participation. Third, the Enterprises eliminated the manual property appraisal requirement.[8] This helped streamline the refinancing process and reduced borrower costs. Fourth, the Enterprises lowered the maximum amount of risk-based fees.[9] And fifth, the Enterprises revised lender solicitation guidelines and permitted lenders to offer additional incentives to borrowers.

b. 2012 and 2013 Modifications

After receiving feedback from stakeholders, FHFA and the Enterprises announced several additional changes to HARP 2.0 in 2012 and 2013. To incentivize lender participation, the Enterprises (1) granted substantial representation and warranty relief for certain HARP refinances, and (2) reduced documentation requirements. Additionally, FHFA extended HARP an additional two years – the program is now scheduled to end on December 31, 2015.

[8] A manual property appraisal is not necessary if the Enterprises' automated valuation models can provide a reliable valuation. Automated valuation models are statistically based programs that use information such as comparable home sales, property characteristics, tax assessments, and price trends to provide an estimate of value for a specific property. Each Enterprise has its own proprietary automated valuation model.

[9] Risk-based fees, also referred to as "loan level price adjustments" or "delivery fees," are fees the Enterprises charge lenders based on higher-risk loan characteristics, such as low credit scores, high LTVs, or limited income and asset documentation.

FIGURE 2. HARP TIMELINE

Date	Event
2009	
•March 4:	FHFA announced the Home Affordable Refinance Program
•July 1:	FHFA raised the HARP-eligible LTV ceiling from 105% to 125%
2010	
•March 1:	FHFA extended HARP's end date from June 10, 2010, to June 30, 2011
2011	
•March 11:	FHFA extended HARP's end date from June 30, 2011, to June 30, 2012
•August 19:	FHFA directed the Enterprises to collaborate with stakeholders to improve HARP 1.0
•October 24:	FHFA publicly announced HARP 2.0; FHFA extended HARP's end date from June 30, 2012, to December 31, 2013
2012	
•September 11:	FHFA announced additional representation and warranty relief for HARP 2.0 loans
•September 14:	The Enterprises announced changes to the income and asset documentation requirements for HARP 2.0 loans
2013	
•March 19:	FHFA announced that it will implement a nationwide HARP education campaign
•April 11:	FHFA extended HARP's end date from December 31, 2013, to December 31, 2015

PROGRAM ASSESSMENT ....

OIG assessed HARP by (1) examining FHFA's administration of the program, (2) analyzing performance data and program outcomes, and (3) identifying the remaining program barriers.

1. FHFA's Administration of HARP

As indicated above, HARP 1.0 produced less than anticipated results. After approximately two and one-half years, fewer than one million of the four to five million HARP-eligible loans had been refinanced. Consequently, FHFA acted to improve the program by collecting and implementing stakeholder feedback, and establishing other initiatives.

Consulting with Stakeholders

FHFA actively engaged with stakeholders to identify and address problems with HARP. To capture the perspective of those involved in the lending process, FHFA facilitated meetings among the Enterprises, lenders, and mortgage insurers. To understand the issues facing borrowers, Fannie Mae conducted a comprehensive survey of HARP-eligible borrowers in 2012; the results of this survey were shared with FHFA.

Stakeholder Meetings

As indicated above, lenders and mortgage insurers are stakeholders whose voluntary participation is necessary for HARP to be successful. Without lender participation, borrowers cannot secure HARP refinances. Additionally, because there are special mortgage insurance requirements for HARP loans, the participation of mortgage insurers is also important. Working with lenders, FHFA and the Enterprises identified several barriers to lender participation during HARP 1.0. For example, many lenders established additional HARP-eligibility standards above and beyond those required by the Enterprises. This resulted in fewer refinances as well as borrower confusion about HARP eligibility.

Beginning with HARP 2.0, FHFA started facilitating regular meetings among the Enterprises, lenders, and mortgage insurers. At these meetings, stakeholders share concerns and constructive criticism about HARP. After receiving feedback from lenders, FHFA and the Enterprises decided to modify HARP. The changes included (1) providing representation and warranty relief for certain loans, (2) reducing documentation requirements, (3) aligning **same servicer** and **new lender** requirements, and (4) aligning Fannie Mae's and

> A **same servicer** refinance refers to a borrower refinancing a loan with the current servicer. A **new lender** refinance refers to a borrower obtaining a loan from a third-party lender that does not currently service the borrower's loan.

Freddie Mac's HARP guidelines. These changes were made to increase lender participation and enhance borrower understanding of the program.

Reducing Lender Representation and Warranty Exposure. During HARP's infancy, lenders were hesitant to participate in the program because the new loans could expose them to new representation and warranty liability. This was an issue for both new lenders and same servicers. New lenders declined to refinance HARP-eligible loans because they did not want the representation and warranty liability for new, high-LTV loans. Moreover, same servicers declined to refinance HARP-eligible loans because they preferred to keep the representation and warranty risk associated with the original loan.[10]

To reduce their representation and warranty exposure, lenders imposed a variety of **credit and process overlays**. These overlays, in effect, prevented higher-risk HARP-eligible borrowers from refinancing with those lenders. Thus, lenders restricted HARP refinances to lower-risk borrowers who exposed them to less representation and warranty risk. For example, some lenders declined to refinance loans with LTVs greater than 105% or loans that they did not currently service.

Credit and process overlays are additional criteria that lenders impose on top of the Enterprises' HARP requirements, including lower LTV ratios, higher credit scores, or greater documentation requirements.

FHFA and the Enterprises addressed this issue by waiving certain representations and warranties for HARP refinances. In November 2011, the Enterprises relieved certain representations and warranties associated with the original loan for same servicer refinances. Despite this modification, lenders continued to communicate to FHFA and the Enterprises that representation and warranty liability was an impediment to their participation. Consequently, in September 2012, FHFA directed the Enterprises to relieve all HARP lenders of liability for the following:

- Representations and warranties associated with the original loan; and

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[10] The Enterprises generally review loans that default within the first two years of origination for violations of representations and warranties. If a representation and warranty violation is found, the Enterprises require the servicer to repurchase the mortgage. Historically, the Enterprises did not review as many loans that defaulted more than two years after origination for breaches of representations and warranties because they assumed that those loans defaulted for reasons unrelated to violations of representations and warranties (e.g., unemployment). As a result, servicers believed that it was better to keep a loan that had a good payment history for several years rather than replace it with a new loan that could default within two years, and thereby unnecessarily expose the servicer to a review of the loan by the Enterprise and possible repurchase request. In September 2012, the Enterprises announced that they were changing their process for reviewing loans for breaches of representations and warranties.

- Representations and warranties associated with the new loan regarding (1) standard eligibility and underwriting; and (2) the value, condition, and marketability of the mortgaged property.[11]

Reducing Documentation. Lenders informed FHFA and the Enterprises that HARP borrower documentation requirements were overly burdensome and did not substantially improve underwriting. Consequently, the Enterprises generally reduced the income and asset documentation requirements, which improved lender efficiency. For example, prior to these modifications, lenders were in some cases required to collect two years of a borrower's income history to establish stability and continuity. Today, lenders are not required to collect such documentation, which helps lenders streamline the refinance process.

Aligning Same Servicer Refinances and New Lender Refinances. Through stakeholder meetings and data collection, FHFA found that same servicer refinances outnumbered new lender refinances. This was attributable to external factors such as lenders focusing on refinancing loans for which they already had underwriting data. However, as lenders began to exhaust their own HARP-eligible loans, FHFA wanted to encourage them to solicit HARP-eligible borrowers outside of the pool of loans they currently service. To facilitate this, FHFA and the Enterprises have generally aligned the same servicer and new lender HARP requirements.[12]

Aligning Fannie Mae and Freddie Mac. FHFA has worked to narrow the differences between the Enterprises' HARP programs. Initially, Fannie Mae and Freddie Mac developed and implemented HARP within their own companies. This created differences between their programs, both substantively and procedurally, which made HARP refinancing more complicated for lenders. FHFA worked with the Enterprises to reduce these differences by aligning the majority of their HARP guidelines. Today, the Enterprises' policies differ in one significant respect – the borrower's option to add closing costs to the loan's principal balance. Freddie Mac limits the amount of **refinance proceeds** that can be used for closing costs to the lesser of 4% of the current unpaid principal

> **Refinance proceeds** refers to the money the borrower receives to pay off the original loan.

[11] The representation and warranty relief for new HARP loans applies if a borrower has an acceptable payment history. An acceptable payment history means the borrower has not been 30 days delinquent during the first 12 months following the date that the Enterprise acquires the HARP loan. Borrowers satisfy this requirement in the vast majority of HARP refinances.

[12] Today, one distinct process difference – income verification requirements – remains between same servicer and new lender refinances. Generally, same servicers are required to verbally verify a borrower's source of income, whereas new lenders are required to obtain documentation to verify the borrower's source of income. This process difference exists because same servicers have an informational advantage over new lenders, such as access to the borrower's original loan file and mortgage payment history.

balance of the original loan or $5,000; Fannie Mae does not limit the borrower's use of refinance proceeds for closing costs.

Borrower Survey

There are a number of borrowers who are eligible for HARP but who have not refinanced. Fannie Mae conducted a survey of these borrowers and borrowers who have completed a HARP refinance. The objective of the survey was to understand (1) why borrowers are not taking advantage of HARP, (2) the role that servicers and lenders play in encouraging HARP-eligible borrowers to refinance, and (3) which solicitation techniques and incentives impact borrowers' willingness to refinance. Fannie Mae made three key findings:

- Some HARP-eligible borrowers, especially high-LTV borrowers, are not refinancing because they do not think they qualify;
- Current servicers are best situated to encourage HARP-eligible borrowers to refinance because these servicers are the borrowers' point of contact; and
- HARP-eligible borrowers may be encouraged to refinance if offered incentives.

Fannie Mae shared the results of its survey with FHFA. FHFA should use the findings in this survey when designing and deploying its nationwide HARP education campaign.[13]

FHFA Initiatives

State-Level Programs

FHFA is seeking to increase HARP **refinance volume** by pursuing state-level support for the program. For example, FHFA is working with state housing finance agencies that receive funds from Treasury's Hardest Hit Fund (HHF).[14] FHFA has worked with agencies in Arizona and Nevada to allocate a portion of their HHF funds to support HARP refinances.[15] Also, at the state level, Michigan allocated $5 million that it received from the National

> **Refinance volume** refers to the number of completed HARP refinances.

[13] OIG reviewed borrower complaints made to OIG, to FHFA, and to federal, state, and local law enforcement agencies about HARP and found that the complaints were consistent with Fannie Mae's survey findings.

[14] The HHF provides funding to certain state housing finance agencies to help prevent foreclosures and stabilize housing markets.

[15] The Enterprises' HARP guidelines permit borrowers to use HHF funds to pay down the existing unpaid principal balance or to pay closing costs for HARP refinanced loans as long as the borrower does not have to repay the state agency.

Mortgage Settlement to assist borrowers with HARP refinances.[16] As a result of these efforts, HARP-eligible borrowers are receiving funds that they may otherwise not have; this extra incentive may be the deciding factor in a borrower's decision to take advantage of HARP and refinance.

Nationwide HARP Education Campaign

In March 2013, FHFA announced that it will be implementing a nationwide public relations campaign to educate borrowers about HARP. This announcement was made in conjunction with FHFA's decision to extend HARP through the end of 2015. The campaign is specifically intended to address the borrower misconceptions that Fannie Mae identified in its borrower survey. FHFA has hired a public relations firm to coordinate and implement the campaign.

FHFA Reporting and Website

FHFA collects refinance data from the Enterprises and publishes monthly refinance reports, which are available to the public. The reports include an overview of HARP as well as certain performance metrics. The analysis in these reports is primarily based on the number of HARP refinances completed during that particular month.

To put these data in better perspective, however, FHFA could compare the number of HARP refinances completed in a month to the total number of HARP-eligible mortgages remaining at the end of the prior month. The ratio of these two numbers is referred to as the **pull-through rate**. Both Enterprises keep these data and analyze them regularly. Although FHFA has access to these data, it has not released these figures to the public.

> **Pull-through rate** is the number of HARP refinances completed divided by the total number of HARP-eligible loans for a given time period.

FHFA also maintains information about HARP on its website; however, the information is limited and disorganized.[17] The HARP-related textbox on FHFA's homepage does not describe what HARP is or how borrowers can benefit from it. For additional information, the textbox directs readers to three external websites before linking them to FHFA's HARP webpage.

Similar to the homepage, FHFA's HARP webpage lacks important details about HARP. For example, it does not describe the basic eligibility requirements. Rather, it is a compilation of

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[16] Michigan borrowers who are approved for a HARP refinance may be eligible to receive $500 to be applied toward closing costs.

[17] Accessed on July 18, 2013.

links to FHFA press releases and external websites. As of July 18, 2013, two of the eight bulleted links were broken and another two links were intended for lenders.

2. Analysis of Performance Data and Program Outcomes

OIG collected various data to measure HARP's performance to date. The following sections contain an analysis of this data, detailing program outcomes from several different perspectives.

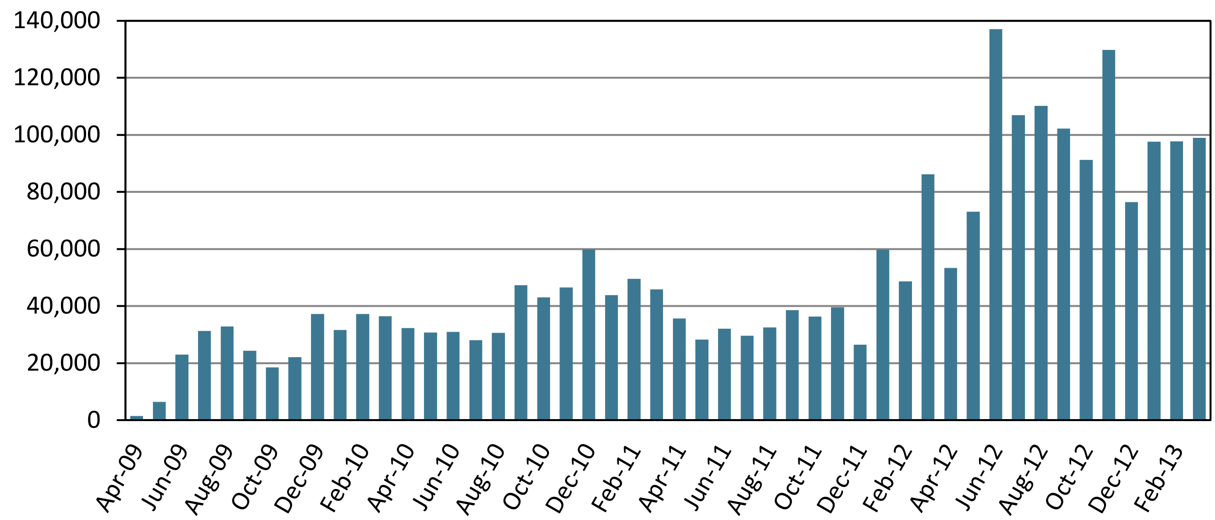
FHFA

The primary metric FHFA uses to measure the success of HARP is volume. When FHFA announced HARP 2.0 in October 2011, lenders had completed 987,910 HARP refinances – the majority of which were for loans with LTVs between 80% and 105%. Thus, more than two years into the program, only a fraction of the four to five million HARP-eligible borrowers had refinanced. When FHFA announced HARP 2.0, it projected that the changes to the program would approximately double the refinance volume to a total of 1.9 million by the program's end date of December 31, 2013.

During the first two quarters of 2012, lenders began to implement the HARP 2.0 changes. The impact of these changes began to show immediately. The HARP monthly refinance volume started to increase beginning in January 2012 (see Figure 3). As of March 2013, lenders had completed 2,459,329 HARP refinances – 58% of which were completed under HARP 2.0.[18] This exceeds the goal of 1.9 million refinances set by FHFA in October 2011.

[18] Fannie Mae has completed 1,431,927 refinances – 60% of which were completed under HARP 2.0. Freddie Mac has completed 1,027,402 refinances – 56% of which were completed under HARP 2.0.

FIGURE 3. TOTAL HARP REFINANCES BY MONTH[19]



Moreover, FHFA incorporates HARP volume in its Annual Performance Plans as one measure of its strategic goal to preserve and conserve the Enterprises' assets. FHFA's FY2012 goal was to have HARP refinances account for at least 10% of all refinances during that period. FHFA exceeded this goal – HARP refinances accounted for 18% of all Enterprise refinances in FY2012. FHFA's FY2013 goal is to complete 600,000 HARP refinances during that time period. During the first six months of the fiscal year, 591,769 HARP refinances have been completed, which puts FHFA on pace to surpass its FY2013 goal.

Borrowers

In addition to considering HARP volume, OIG requested HARP data from the Enterprises to understand various borrower-focused program outcomes.

Decrease in Monthly Mortgage Payments

The average borrower's monthly savings that results from a HARP refinance is an important outcome. By lowering the borrower's monthly principal and interest payments, HARP reduces the risk of future default and potentially stimulates the economy. According to Fannie Mae's 2012 data, HARP borrowers saved on average over $250 per month, or $3,000 per year.[20]

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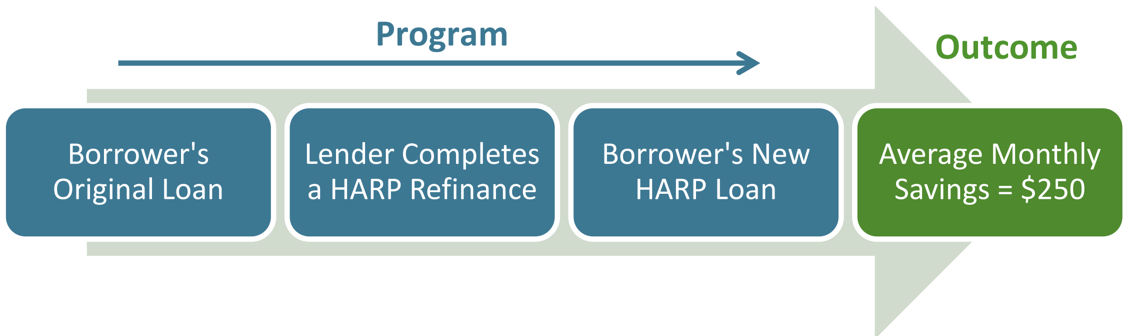
[19] Source: FHFA, Fannie Mae, and Freddie Mac.

[20] Not all HARP loans result in lower monthly mortgage payments. For example, a borrower may increase the monthly mortgage payment by refinancing into a loan with a shorter amortization period to build equity faster.

FIGURE 4. AVERAGE MONTHLY SAVINGS

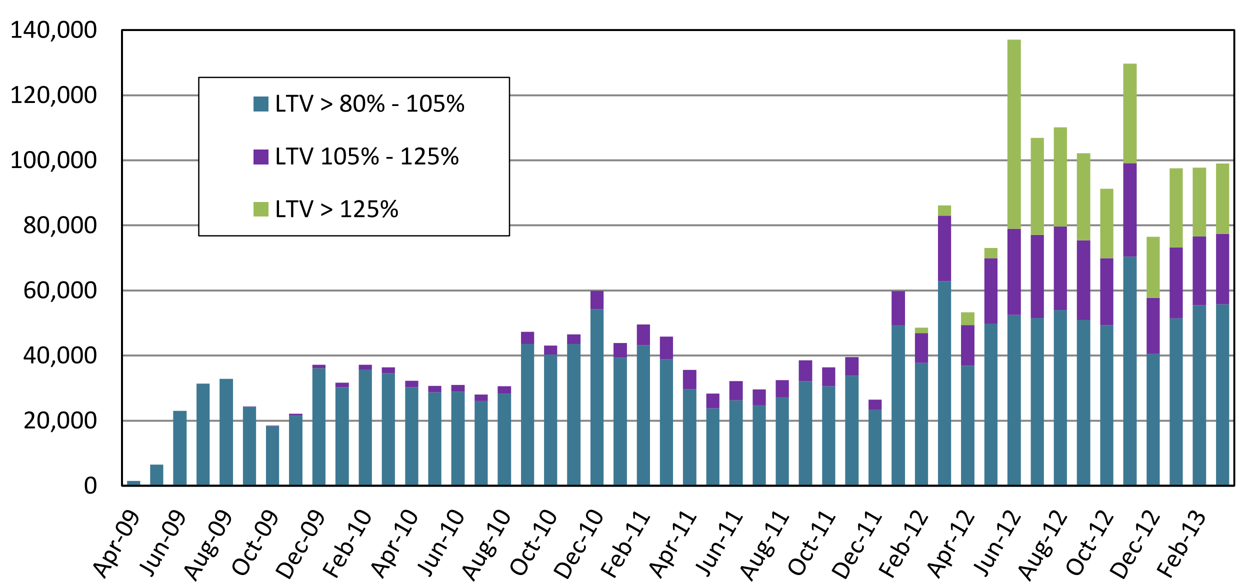


Increase in High LTV Refinances

Prior to HARP 2.0, the refinance volume for loans with LTVs greater than 105% was relatively small. To address this, FHFA directed the Enterprises to make two important changes: (1) remove the 125% LTV ceiling, and (2) relieve lenders of significant representation and warranty liability.

Figure 5 illustrates the effect these changes had on high-LTV loans. As lenders began to implement these changes in early 2012, refinance volume for loans with LTVs between 105% and 125% began to increase. Then, in June 2012, the Enterprises permitted lenders to deliver HARP loans with LTVs greater than 125% into special mortgage-backed securities (MBS); immediately thereafter, refinance volume for these loans dramatically increased.

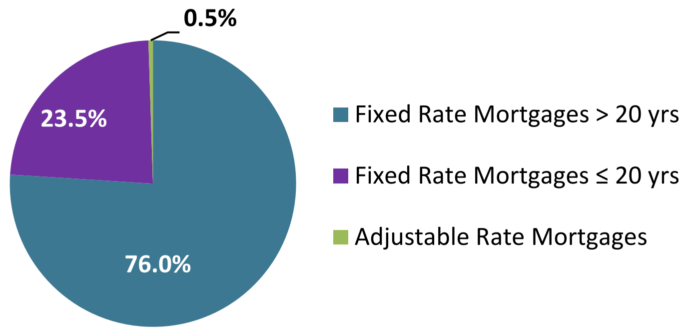
FIGURE 5. HARP REFINANCES BY LTV: INCEPTION TO MARCH 2013[21]



[21] Source: FHFA, Fannie Mae, and Freddie Mac.

Increase in Mortgage Stability

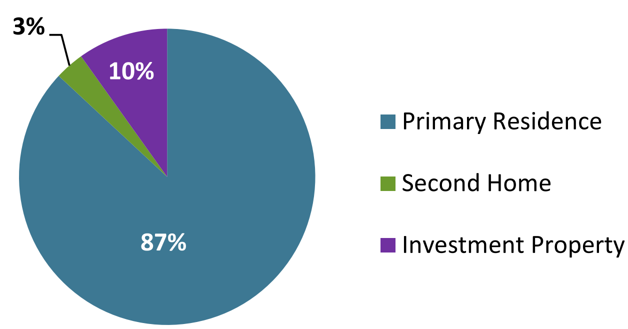
FIGURE 6. FANNIE MAE HARP REFINANCES BY MORTGAGE PRODUCT TYPE: JANUARY TO DECEMBER 2012[22]



HARP was also designed to place borrowers in more stable mortgage products (e.g., 30-year fixed rate mortgages) or, if possible, shorten their loan terms to build equity faster. As shown in Figure 6, over 75% of HARP borrowers refinanced into fixed rate mortgages with terms greater than 20 years, whereas less than 1% of borrowers refinanced into less stable adjustable rate mortgages. Further, a significant percentage of borrowers chose to refinance into fixed rate mortgages with terms of 20 years or less, which allows them to build equity in their homes faster.

Focus on Refinancing Primary Residences

FIGURE 7. HARP REFINANCES BY OCCUPANCY TYPE: INCEPTION TO MARCH 2013[23]



HARP refinances are not limited to primary residences; both second homes and investment properties are HARP-eligible if they meet all the other HARP criteria.[24] As shown in Figure 7, however, the majority of HARP refinances are for primary owner-occupied residences. This is due, in part, to lenders prioritizing the refinancing of primary residences before secondary homes and investment properties.

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[22] Source: Fannie Mae. Freddie Mac data reveal a similar trend. Note that the Enterprises only permit borrowers with LTVs less than 105% to refinance into an adjustable rate mortgage.

[23] Source: FHFA, *Refinance Report: March 2013*, at 4 (June 12, 2013) (online at www.fhfa.gov/webfiles/25318/March2013RefinanceReport.pdf).

[24] Both second homes and investment properties have been HARP-eligible from the program's inception.

Enterprises

As the regulator and conservator of the Enterprises, FHFA is responsible for stabilizing the mortgage market while simultaneously conserving the Enterprises' assets. These two mandates create an inherent tension.[25] FHFA established HARP in the wake of the housing crisis as a public policy program. Yet, the program also affects the Enterprises financially. FHFA has expressed that HARP's financial impact on the Enterprises is a secondary consideration to the program's success. This, however, raises an important question regarding the conservatorship: what is the potential cost of HARP to the Enterprises and, ultimately, to taxpayers?[26]

This section explores HARP's financial impact on the Enterprises. The *net* impact is primarily a function of five variables:

- Credit risk
- Guarantee fees
- Retained portfolio investments
- Representation and warranty relief
- Opportunity cost

These variables are individually examined below. Because of the influence of numerous economic and market forces on these variables, their impact can only be approximated at best.[27] However, OIG has reached several general conclusions about these variables.

Credit Risk Benefit

> **Credit risk** refers to the risk that a borrower will default on the mortgage.

The **credit risk** associated with a loan indicates the likelihood of credit losses to the Enterprises as a result of the loan's default. Therefore, loans with a high credit risk are likely to result in more credit losses than loans with a low credit risk. The Enterprises model a loan's credit risk as a function of the borrower's credit profile, the loan's LTV, the

[25] *See* OIG, *White Paper: FHFA-OIG's Current Assessment of FHFA's Conservatorships of Fannie Mae and Freddie Mac*, at 28-29 (WPR-2012-001) (Mar. 28, 2012) (online at www.fhfaoig.gov/Content/Files/WPR-2012-001.pdf).

[26] For a detailed analysis of the relationship between the Enterprises and taxpayers, *see* OIG, *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements* (WPR-2013-002) (Mar. 20, 2013) (online at www.fhfaoig.gov/Content/Files/WPR-2013-002_2.pdf).

[27] Quantifying an estimate through economic modeling is beyond the scope of this evaluation.

presence of mortgage insurance, the amount of loan documentation, the mortgage product (e.g., adjustable rate or fixed rate mortgage), the occupancy type, and local and regional economic conditions.

The credit risk associated with a HARP loan is intuitively lower than the credit risk associated with its original counterpart. In other words, a HARP borrower is less likely to default on the new mortgage than on the original mortgage. This flows from the fact that the new mortgage has, at a minimum, a lower interest rate, a lower monthly payment, or a shorter amortization term than the original loan. Additionally, the original loan may have been refinanced into a more stable mortgage product, which also reduces its risk of default. Consequently, the Enterprises anticipate that new HARP loans will perform better, on the whole, than the original loans would have, thereby reducing future credit losses.[28] In this respect, the Enterprises financially benefit from HARP.

Guarantee Fee Benefit

In exchange for guaranteeing the payment of a loan's principal and interest to MBS investors, the Enterprises charge a guarantee fee (g-fee). Today, the Enterprises' average g-fee to insure a loan is higher than it was prior to 2009. In other words, the Enterprises charge a greater premium to insure MBS today than they did before the housing crisis.

Just as a borrower is released from the terms of the original loan during a refinance, the Enterprises are likewise released from the original g-fee structure. After the borrower refinances, the Enterprises can securitize the refinanced loan and charge today's higher g-fee. Thus, the Enterprises realize a financial benefit in the difference between the g-fee associated with the original loan and the g-fee associated with the new loan.

Retained Portfolio Cost

HARP refinances negatively impact the Enterprises' retained portfolios. As part of their business models, the Enterprises buy and hold individual mortgages and MBS to earn interest income. These portfolios of mortgages and MBS are referred to as the Enterprises' retained portfolios. In addition to credit risk, the retained portfolios expose the Enterprises to **prepayment risk**.

Prepayment risk refers to the risk that the underlying mortgage will be paid off early resulting in less interest income for the holder of the debt.

[28] The net effect of adding origination fees to the new loan's balance is negligible. In the case of default, the Enterprises will be exposed to greater credit losses. However, if the borrower does not default, the loan is more valuable because of the greater loan balance.

The Enterprises' retained portfolios include HARP-eligible mortgages. When these mortgages are refinanced (i.e., prepaid), the Enterprises no longer receive the interest payments on the original loan. Then, the Enterprises purchase or guarantee the new loan that is issued at a lower interest rate than the original loan and, thus, is less valuable. The effective cost to the Enterprises is the difference in value that is derived from the net interest rate spread between the original loans and the new loans.

Representation and Warranty Relief Cost

As noted above, lenders provide certain representations and warranties regarding the integrity of loans when they sell them to the Enterprises. If Fannie Mae or Freddie Mac discovers that a lender has breached any of these representations or warranties, it can request the lender to repurchase the loan. Over the previous two years, the Enterprises have received a significant amount of money from lenders repurchasing defective loans that were sold to the Enterprises prior to 2009.[29]

To encourage lenders to participate in HARP, FHFA directed the Enterprises to waive significant representation and warranty protection for all HARP refinances.[30] Therefore, if the Enterprises do not identify a defect in the original loan prior to the HARP refinance, they will likely be unable to pursue a repurchase.[31] In this situation, the Enterprises retain the loan's credit risk, which would otherwise be returned to the original lender. Consequently, representation and warranty relief associated with HARP may negatively impact the Enterprises financially. In its 2012 public filings, Freddie Mac raised this concern.

HARP-eligible loans, however, are seasoned loans made to borrowers who have demonstrated their ability and commitment to repay their mortgages.[32] Typically, the Enterprises detect a loan's representation and warranty defects within the first three years of its delivery. Therefore, the actual cost of eliminating the representations and warranties on HARP-eligible loans is mitigated by their loan characteristics.

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[29] For example, in January 2013, Bank of America paid Fannie Mae $3.6 billion and repurchased $6.6 billion of loans to settle outstanding repurchase requests for loans originated from 2000 to 2008.

[30] As discussed above, both same servicers and new lenders are relieved of representations and warranties for the original mortgage and the new HARP mortgage if certain criteria are met. Note that lenders are not relieved of representations and warranties related to the Enterprises' charters; misstatements, misrepresentations, omissions, or data inaccuracies; clear title and enforceable first lien position; compliance with applicable laws; and salability of the mortgage to the Enterprise.

[31] If a borrower becomes more than 30 days delinquent within the first 12 months of an Enterprise acquiring the refinanced loan, that Enterprise has the right to pursue all of the representations and warranties for the HARP loan.

[32] To qualify for HARP, the borrower must be current on the mortgage at the time of the refinance, with no late payment in the past 6 months and no more than 1 late payment in the past 12 months.

Opportunity Cost

If HARP did not exist, it is conceivable that some HARP-eligible borrowers would conventionally refinance their loans. In this scenario, the borrower would have to acquire additional mortgage insurance or add a sufficient amount of equity for the loan to be Enterprise-eligible.[33] This would reduce the Enterprises' exposure to credit losses from a borrower default. Additionally, it is conceivable that the new loan would not be purchased or guaranteed by the Enterprises, thereby relieving them of all credit risk formerly associated with that loan.

With HARP, however, there is no need for HARP-eligible borrowers to acquire additional mortgage insurance or add equity. Moreover, all HARP refinances are subsequently purchased or guaranteed by the Enterprises. Thus, because HARP exists, the Enterprises forego the opportunity to (1) reduce their credit risk through additional borrower credit enhancements, or (2) relieve themselves of the loan entirely.

3. Remaining Barriers

Despite the modifications that FHFA has instituted throughout HARP, OIG has identified several remaining program barriers.

Borrower Challenges

Borrower Knowledge

OIG found that borrower knowledge and understanding of HARP remains a critical barrier to the program. This is because many borrowers have not heard of the program, confuse the program with other government housing programs, or do not realize that they are eligible.

Under HARP 1.0, borrowers were rejected by lenders for various reasons that contribute to today's confusion. Lenders turned borrowers away because of credit and process overlays and capacity constraints.[34] This left many borrowers frustrated or under the mistaken impression that they were ineligible for HARP. Additionally, borrowers may not be aware that they are permitted to refinance their mortgages with any participating lender.

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[33] The Enterprises' charters generally prohibit them from purchasing first lien single-family mortgages if the LTV is greater than 80% unless there is some type of credit enhancement, such as mortgage insurance.

[34] It is the lender's prerogative to establish credit and process overlays. Thus, if HARP-eligible borrowers are turned down by one lender due to an eligibility overlay, then those borrowers may think that they are not HARP eligible.

As a result of the changes to HARP implemented throughout 2011, 2012, and 2013, lenders have largely removed their credit and process overlays and increased their capacity. However, the challenge of educating borrowers about HARP eligibility and lender options remains, especially for reaching borrowers who previously tried to refinance under HARP 1.0 and were denied.

FHFA and the Enterprises have acknowledged that borrower outreach is critical to increasing HARP refinances. Prior to HARP 2.0, lenders were prohibited from directly soliciting borrowers with HARP-eligible loans for refinancing. To improve borrower knowledge of the program and encourage borrowers to refinance, FHFA and the Enterprises revised the solicitation guidelines for HARP loans. Lenders are now generally permitted to actively contact HARP-eligible borrowers and have been aggressively sending HARP solicitations to them.

Despite lenders' solicitation efforts, some HARP-eligible borrowers do not respond to solicitations because they are not familiar with the lender or believe their underwater loan does not qualify for HARP. To address this issue, lenders are permitted to co-brand solicitation materials with the Enterprises' names and a lender's name to strengthen lender credibility among borrowers. Fannie Mae has also been designing solicitation templates and marketing materials for lenders to send to HARP-eligible borrowers. In addition to informing borrowers that they may potentially be eligible for a HARP refinance, the materials provide illustrations of the benefits of HARP. For example, the materials illustrate that one of the potential benefits is a reduction in borrowers' monthly principal and interest payments. Also, the Enterprises have continued to add and update HARP content on their websites with information specifically targeted at informing borrowers about HARP. This includes answering basic questions about HARP, providing eligibility criteria, and listing participating lenders. As of the date of this assessment, more than 250 servicers and lenders are participating in HARP.

Through conversations with lenders and borrower outreach, the Enterprises found that there is a subset of borrowers who are eligible for HARP, but are not interested in refinancing despite the potential benefits. In an effort to encourage these borrowers to apply, the Enterprises authorized lenders to offer incentives to borrowers who refinance under HARP. At their discretion, lenders are now permitted to make a contribution to the borrower of up to $2,000 to reduce the HARP-refinanced loan's unpaid principal balance. Additionally, lenders may offer a $500 cash equivalent, such as a gift card, to borrowers during the HARP refinance process.[35] The Enterprises do not reimburse lenders for either borrower incentive.

[35] The lender cannot require the borrower to repay either amount. Additionally, the lender must disclose the contribution in the HUD-1 form as a lender credit.

Origination Fees and Closing Costs

As noted above, HARP refinances have origination fees and closing costs like other mortgage transactions. This includes costs for the application, processing, appraisal, title search, and other necessary items to complete the refinance.[36] OIG found that these upfront fees may be a deterrent for potential borrowers. FHFA and the Enterprises are aware of this issue, have taken steps to mitigate it, and offer alternatives for borrowers with limited capital.

In October 2011, FHFA modified two components of HARP to alleviate the borrower's burden. FHFA directed the Enterprises to (1) limit risk-based fees and (2) expand the use of automated valuation models. Both of these changes reduce closing costs.

Additionally, a borrower has the option to borrow closing costs as part of the refinance. This approach, however, increases the borrower's unpaid principal balance and reduces the borrower's equity. As noted above, Fannie Mae currently permits all origination fees and closing costs to be added to the loan balance. Freddie Mac, however, limits the amount of refinance proceeds that can be added to the loan balance to the lesser of $5,000 or 4% of the unpaid principal balance.[37] To support its position, Freddie Mac contends that HARP is a program designed to help borrowers build equity in their homes. By limiting the increase in the borrower's unpaid principal balance, Freddie Mac is managing the credit risk associated with the new loan. Moreover, a borrower has the option to finance the closing costs through a higher interest rate.

Mortgage Insurance

HARP has special requirements for mortgage insurance that are intended to make it easier for borrowers with high-LTV loans to refinance. Loans that do not have mortgage insurance coverage at the time of refinancing are not required to obtain mortgage insurance. Loans that do have mortgage insurance, however, are required to retain mortgage insurance coverage at the same coverage level for the newly refinanced HARP loan. This applies to both borrower paid mortgage insurance and lender paid mortgage insurance (LPMI).[38]

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[36] On average, closing costs amount to 3% to 6% of the unpaid principal balance being refinanced.

[37] Several mortgage insurance companies have also implemented caps on the amount of costs and fees that can be added to the unpaid principal balance of the HARP loan.

[38] LPMI is a type of mortgage insurance policy that is taken out by the lender at the time the loan is originated and is attached for the life of the loan. The policy allows the lender to collect a higher interest payment from the borrower and to forward the excess interest to the mortgage insurance company to pay for the mortgage insurance.

Under HARP 1.0, borrowers who had loans with mortgage insurance had difficulty refinancing because the transfer of the mortgage insurance to the refinanced loan was cumbersome for the same servicer, new lender, and the mortgage insurer. Same servicers generally viewed loans with mortgage insurance as a "hassle factor" that disrupted the streamlined refinance process. New lenders found it difficult to refinance loans with mortgage insurance because it was problematic for the servicer of the old loan and the lender of the new loan to coordinate transfer of the mortgage insurance policy. Therefore, some servicers and lenders declined to refinance loans with mortgage insurance.

OIG found that since the implementation of HARP 2.0 the transfer of mortgage insurance has become considerably less cumbersome. As a result, the majority of mortgage insurance companies voluntarily agreed to make the mortgage insurance policies fully transferable to new HARP loans.

However, OIG found anecdotal evidence indicating that borrowers with LPMI face barriers to refinancing under HARP. Although both Enterprises permit loans with LPMI to be refinanced under HARP, the complicated nature of this type of insurance may make it difficult for lenders to transfer. The Enterprises have tried to address this by permitting the borrower to obtain either LPMI or borrower paid mortgage insurance for the new HARP loan. Ultimately, it is up to the lenders to decide whether they will refinance loans with LPMI.

Lender Challenges

Prior to the announcement of HARP 2.0, lenders informed FHFA and the Enterprises that they were hesitant to invest in systems and personnel for HARP because of the program's short duration. This resulted in lender capacity constraints – lenders were unable to handle the volume of borrowers seeking HARP refinances.

In October 2011, FHFA addressed this issue by extending HARP through 2013. By extending the program, FHFA created an additional incentive for lenders to invest in employees and systems to process HARP refinances. Then, in April 2013, lenders were given greater impetus to increase capacity for HARP refinancing when FHFA extended the program through 2015.

As a result of the program extensions and increased borrower demand, lenders are devoting more resources and personnel to handle the HARP refinance volume. However, OIG found anecdotal evidence that lenders continue to experience capacity constraints causing some HARP-eligible borrowers to wait up to 60 days or more for a refinance.

To manage their capacity, lenders try to use their resources as efficiently as possible. Lenders are more likely to refinance loans for current customers before accepting HARP applications from new borrowers who are not current customers. Several major lenders, however, have begun to deplete their HARP-eligible portfolios and are starting to target other HARP-eligible borrowers outside of their servicing portfolio. Moreover, a number of lenders have begun to participate in HARP, which helps alleviate capacity constraints, increase competition, and provide borrowers with a greater selection of lenders.

4. The Future

Helping underwater borrowers refinance their mortgages remains a frequent topic of public discourse. HARP 3.0 generally refers to further modification of HARP through proposed legislative action. For example, the Responsible Homeowner Refinancing Act of 2013 is pending HARP-related congressional legislation.[39] While this proposal seeks to codify most of today's HARP 2.0 guidelines, it contains several deviations. For example, the proposal removes the minimum LTV eligibility requirement. Thus, if enacted, it would expand HARP to include borrowers with LTVs less than 80%. Other stakeholders have suggested that Congress should expand HARP to include loans that are not currently owned or guaranteed by either of the Enterprises. Again, this would further broaden the HARP-eligible population. Analysis of potential legislation, however, is beyond the scope of this report.

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[39] S. 249, 113th Cong. (2013); H.R. 736, 113th Cong. (2013).

CONCLUSION

As a result of the HARP 2.0 modifications, HARP refinance volume increased substantially – particularly for loans with LTVs greater than 105%. As of March 2013, there have been more than 2.4 million HARP refinances. Additionally, HARP refinances are currently being originated by more than 250 participating lenders. FHFA's active administration of HARP and its engagement of stakeholders have contributed to these outcomes. However, with over two years left in the program, it is difficult to project how many HARP-eligible loans ultimately will be refinanced because, among other factors, educating borrowers and encouraging their participation continue to be major challenges.

OBJECTIVE, SCOPE, AND METHODOLOGY ....

OIG consulted a variety of public and nonpublic sources for this evaluation including:

- FHFA directives, documents, emails, reports, and press releases;
- Enterprise documents, servicer announcements, and press releases;
- Data published or provided by FHFA and the Enterprises;
- FHFA's and the Enterprises' websites;
- Borrower complaints made to OIG, FHFA, and the Consumer Sentinel Network;[40]
- Congressional testimony and speeches of FHFA employees;
- Interviews with FHFA and Enterprise employees; and
- Industry publications.

OIG analyzed these sources by:

- Examining the purpose of HARP and what FHFA and the Enterprises are doing to help HARP achieve its purpose;
- Identifying and gathering data on outputs and outcomes of HARP;
- Analyzing impacts of external factors on HARP that neither FHFA nor the Enterprises can control such as interest rates, participation by lenders and mortgage insurers, and borrower interest in refinancing; and
- Reviewing the Government Performance and Results Modernization Act of 2010, which establishes federal planning standards.[41]

This program evaluation was designed to evaluate HARP using the Enterprises' current definition of a HARP-eligible borrower. It does not evaluate the program as it existed prior to HARP 2.0, nor does it evaluate potential future program changes, such as further broadening or narrowing today's eligibility parameters.

This evaluation was conducted under the authority of the Inspector General Act, as amended, and is in accordance with the *Quality Standards for Inspection and Evaluation* (January

[40] The Federal Trade Commission's Consumer Sentinel Network is a database of consumer complaints collected from federal, state, and local law enforcement agencies.

[41] For example, the establishment of timelines and benchmarks is critical to assess progress in implementing plans and is consistent with Government Performance and Results Modernization Act planning requirements.

2012), which was promulgated by the Council of the Inspectors General on Integrity and Efficiency. These standards require OIG to plan and perform an evaluation that obtains evidence sufficient to provide reasonable bases to support this program assessment. OIG believes that this report meets these standards.

The performance period for this evaluation was from February 2012 to June 2013.

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